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France is, as so often, riven by strikes and protests. Its politicians need to level with the French people about the need to embrace change: leader

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Politics this week

Mar 30th 2006
From The Economist print edition

AP

The new Kadima party, founded by Ariel Sharon, won the largest number of parliamentary seats (28) in **Israel's general election**. Mr Sharon's former party, the Likud, did poorly, winning only 11 seats, whilst Labour won 20. But Kadima, led by acting prime minister Ehud Olmert, won less decisively than expected, which should make forming a stable coalition harder. See article

A cabinet formed by the Islamist party, Hamas, won a parliamentary vote and formed a **Palestinian** government. Ismail Haniya was sworn in as prime minister. He urged the international community not to punish the Palestinian people for their support of Hamas by suspending aid. See article

After three weeks of argument, the UN Security Council issued a presidential statement calling on **Iran** to suspend uranium enrichment. At the insistence of Russia and China, a phrase saying that Iranian nuclear weapons would be a threat to peace was excised from the final text. See article

In **Iraq**, the American army faced mounting anger and political pressure from Shias after a combined raid with the Iraqi army on a Baghdad mosque complex killed about 20 people. Elsewhere in the country, scores more bodies were found, victims of a wave of sectarian violence that has driven 30,000 people from their homes. See article

In **Nigeria**, the remaining three Western oil workers kidnapped by militants demanding a bigger local share of oil revenues flowing from the Niger Delta region were released.

At a summit in Khartoum, Sudan, the **Arab League** pledged to fund the embattled and under-resourced African Union force in the Darfur region of the country for the next six months. The UN is expected to assume control of the force in October.

After nearly three years in exile in Nigeria, **Charles Taylor**, a former Liberian president, was taken into custody by the international war-crimes tribunal in Sierra Leone. He faces trial on 17 counts of war crimes and crimes against humanity for his alleged role in Sierra Leone's brutal civil war. See article

Expensive exit

Antonio Palocci, **Brazil's** powerful finance minister, resigned because his office was party to the leaking of bank-account details of a witness against him in a corruption scandal. His replacement, Guido Mantega, was the head of the country's largest development bank. The real and Brazil's bonds both lost value. See article

EPA

Animal-rights activists, including Brigitte Bardot and Sir Paul McCartney, tried to hinder an annual cull of 325,000 harp seals in eastern **Canada**, which officials say is needed to control their numbers.

Hell, no, we won't vote

In **Thailand**, protestors staged a final demonstration in protest at an election due on April 2nd, which the prime minister, Thaksin Shinawatra, has called early in an attempt to disarm his critics. The main opposition parties are boycotting the poll. See article

An **Afghan** Muslim, who escaped a possible death sentence for the crime of becoming a Christian, arrived in Italy where he was immediately granted asylum.

The first jail sentence given to medical professionals for aborting a female fetus was handed down in **India**. A doctor and his assistant were sentenced to two years for revealing the sex of the fetus, illegal under Indian law, and then agreeing to abort it. A recent report estimated that around 10m female fetuses have been aborted in India in the past 20 years.

By nEo

Pakistan praised an offer by India's prime minister, Manmohan Singh, of a treaty of friendship, peace and security, between the two adversaries.

Talking to the enemy

Negotiations continued in **Ukraine** to form a coalition government following a parliamentary election. President Viktor Yushchenko's party fared badly, taking 14% of the vote, forcing him to talk to Yulia Tymoshenko, his former "orange revolution" ally, about returning to her old job of prime minister. See article

Belarus continued to clamp down on protests against Alyaksandr Lukashenka's victory in the recent presidential election. A former Polish ambassador to the country was among those jailed. NATO joined Western governments in denouncing the election as flawed and is to review its strategic pact with Belarus. See article

Strikes and demonstrations continued across **France** against a new labour contract for the young. Though most protests were peaceful, skirmishes broke out in Paris. See article

Turkey tried to reassure markets that its president's decision to veto the appointment of an Islamist as governor of the central bank was not a crisis. Adnan Buyukdeniz was nominated by the ruling Justice and Development Party, which has seen several of its nominations to key government posts rejected by Turkey's secular institutions. See article

The fall guy

AFP

Andrew Card resigned as **George Bush's chief of staff**. He held the post longer than anyone since the Eisenhower administration, but was blamed by some Republicans for the slide in the president's popularity. He was replaced by Josh Bolten, the current budget director. See article

Jack Abramoff was sentenced to six years in prison for fraud in Florida. The former lobbyist will not be sent behind bars just yet as he is co-operating with a federal investigation in a separate fraud and bribery case, for which he made a plea-bargain deal in January and is yet to be sentenced.

Around half a million people demonstrated in Los Angeles against stringent **immigration** proposals that are being championed by Republicans in Congress. However, a committee in the Senate approved a bill combining tighter border security with ways to allow illegal migrants to become citizens and others to come as guest-workers. See article

The **Supreme Court** heard an appeal by Osama bin Laden's former driver, which challenges the use of presidential powers to try suspected terrorists in military tribunals. The court is expected to rule later this year.

In a unanimous vote, the Federal Election Commission decided that political websites, such as **internet blogs**, can remain broadly unregulated in what they publish (except for paid political advertising).

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Business this week

Mar 30th 2006
From The Economist print edition

In a move that might placate its disgruntled shareholders, **DaimlerChrysler** announced another overhaul at its loss-making **Smart** microcar unit, which includes scrapping the unpopular four-seater model. The restructuring should help the carmaker's Mercedes division, of which Smart is a part. Last year Mercedes made its first operating loss in a decade, but DaimlerChrysler's plans will cut its overheads by consolidating Smart's separate production lines. See article

General Motors revealed it would have to restate financial results for several years at **GMAC**. The carmaker is hoping to sell a majority stake in its mortgage and financial services unit as part of its strategy to raise cash and improve its credit rating. As part of this strategy, GM is continuing to divest its holdings in Japan; it is also in talks with three potential buyers to sell its 7.9% stake in **Isuzu Motors**.

In a hearing before America's Supreme Court, **eBay** argued that it and other e-commerce companies were being subjected to unnecessary lawsuits from “patent trolls” that aggressively seek patent royalties. The online auctioneer is defending its website's “Buy it Now” feature, which it says it has sufficiently altered since a court ruled in 2003 that it infringed patents held by MercExchange, a technology firm. See article

The men from the Pru

Just a few days after **Aviva** confirmed it had launched a bid to buy **Prudential**, it abandoned its £17 billion ($30 billion) offer due, it said, to a lack of “co-operation” from the Pru's board. The move didn't dampen speculation among investors that both British insurance firms are now likely takeover targets.

NASDAQ withdrew its bid for the **London Stock Exchange**. It joins a long line of suitors that have wilted at the displeasure of the LSE's board at the value of its offer (even though some of its major shareholders expressed positive feelings to the approach).

The Securities and Exchange Commission overturned a lifetime ban on **Frank Quattrone** from working in the securities industry. The SEC said the ban, imposed in 2004 by the National Association of Securities Dealers, America's regulator of brokerage firms, was hasty and “not in accordance” with NASD's rules.

A white knight to the rescue

Temasek, the Singaporean government's investment company, bought an 11.6% stake in **Standard Chartered** from the estate of a deceased local banking tycoon, who helped the bank defeat a takeover bid in 1986. It was rumoured that several American and British financial institutions had been interested in the stake, worth £2.3 billion ($4 billion), as a step towards launching a bid for the London-based firm, which makes most of its profit in Asia.

Investors gave their seal of approval to a decision by antitrust officials to allow the $1.7 billion merger between **Maytag** and **Whirlpool**, which both make electrical appliances (Maytag's share price increased by 28%). The news ends a saga that heated up when China's Haier made a bid for Maytag last year.

Grupo Ferrovial said it was employing Australia's **Macquarie Bank** as an adviser in its hostile bid to buy **BAA**, the operator of seven British airports, including Heathrow. As part of their arrangement, the Spanish firm, which specialises in infrastructure, struck a deal to sell its 21% stake in Sydney airport to Macquarie if it succeeds in winning BAA (for which Macquarie had been expected to mount a rival bid).

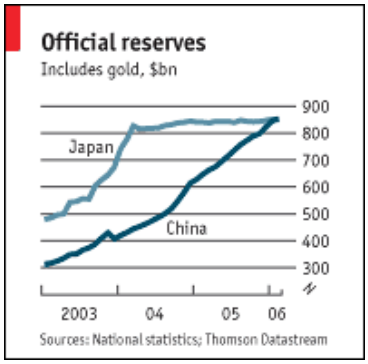
GUS, a British retailer and business services group, confirmed that it was planning to split itself in two and list its **Argos Retail Group** and **Experian** divisions on the stockmarket. The plan to demerge was expected (GUS sold its stake in Burberry last year), but private-equity groups had expressed interest in Experian, a credit-checking business based in California.

Accenture, a consulting firm, reported that net profit for the three months ending February 28th had fallen by 67%, compared with a year earlier, as it booked a $450m charge for losses associated with its contract to provide

Britain's National Health Service with a new IT system. Problems with integrating and developing the system are proving more difficult for Accenture than it indicated last year.

Money in the bank

China surpassed Japan as the world's biggest holder of **foreign reserves**. The news came amid more politicking over China's currency policy, which American politicians regard as a cause of their trade deficit. Charles Schumer, a senator who has been shrill in his attacks on Beijing, dropped plans, for the moment at least, to slap a 27.5% tariff on Chinese goods, partly in response to signals from China that it would allow its currency to float more freely. See article



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France

France faces the future

Mar 30th 2006
From The Economist print edition

The country's politicians need to level with the French people on the need to embrace change

Get article background

"THE French constitute the most brilliant and the most dangerous nation in Europe and the best qualified in turn to become an object of admiration, hatred, pity or terror but never indifference." Thus did a young Alexis de Tocqueville describe his motherland in the early 19th century. His words still carry a haunting truth. Over the past few years, as other western democracies have shuffled quietly along, France has by turns stunned, exasperated and bemused. This week's massive one-day protest, drawing 1m-3m people on to the streets, was no exception (see article). This particular stand-off, between the centre-right government of Dominique de Villepin and those protesting against his effort to inject a tiny bit of liberalism into France's rigid labour market, may be defused. The Constitutional Council was due to rule on the legality of the new law on March 30th. But the underlying difficulty will remain: the apparent incapacity of the French to adapt to a changing world.

On the face of it, France seems to be going through one of those convulsions that this nation born of revolution periodically requires in order to break with the past and to move forward. Certainly the students who kicked off the latest protests seemed to think they were re-enacting the events of May 1968 their parents sprang on Charles de Gaulle. They have borrowed its slogans ("Beneath the cobblestones, the beach!") and hijacked its symbols (the Sorbonne university). In this sense, the revolt appears to be the natural sequel to last autumn's suburban riots, which prompted the government to impose a state of emergency. Then it was the jobless, ethnic underclass that rebelled against a system that excluded them.

Yet the striking feature of the latest protest movement is that this time the rebellious forces are on the side of conservatism. Unlike the rioting youths in the *banlieues*, the objective of the students and public-sector trade unions is to prevent change, and to keep France the way it is. Indeed, according to one astonishing poll, three-quarters of young French people today would like to become civil servants, and mostly because that would mean "a job for life". Buried inside this chilling lack of ambition are one delusion and one crippling myth.

The delusion is that preserving France as it is, in some sort of formaldehyde solution, means preserving jobs for life. Students, as well as unqualified suburban youngsters, do not today face a choice between the new, less protected work contract and a lifelong perch in the bureaucracy. They, by and large, face a choice between already unprotected short-term work and no work at all. And the reason for this, which is also the reason for France's intractable mass unemployment of nearly 10%, is simple: those permanent life-time jobs are so protected, and hence so difficult to get rid of, that many employers are not creating them any more.

This delusion is accompanied by an equally pernicious myth: that France has more to fear from globalisation, widely held responsible for imposing the sort of insecurity enshrined in the new job contract, than it does to gain. It is true that the forces of global capitalism are not always benign, but nobody has yet found a better way of creating and spreading prosperity. In another startling poll, however, whereas 71% of Americans, 66% of the British and 65% of Germans agreed that the free market was the best system available, the number in France was just 36%. The French seem to be uniquely hostile to the capitalist system that has made them the world's fifth richest country and generated so many first-rate French companies. This hostility appears to go deeper than resistance to painful reform, which is common to Italy and Germany too; or than a desire for a strong welfare state, which Scandinavian countries share; or even than a fondness for protectionism, which America periodically betrays.

The limits to change by stealth

A common feature unites France's underclass rioters and the rebellious students, as well as the election of the far-right Jean-Marie Le Pen into the run-off of the 2002 presidential election. This is the failure of the French political class over the past 20 years to tell it straight: to explain to the electorate what is at stake, why France needs to

adapt, and why change need not bring only discomfort. This failure has bred a political culture of reform by stealth, in which change is carried out with one hand and blamed on outside forces—usually globalisation, the European Union or America—while soothing words about protecting the French way are issued on the other. After a while, the credibility gap tears such a system apart. The French voted for Mr Le Pen in part because they were fed up with the stale mainstream political class. The *banlieues* exploded because unemployed minorities were fed up hearing that they did not belong. The students and trade unions are in revolt because they do not trust the government to protect them.

Part of the blame for this lies squarely with President Jacques Chirac. He has presided for nearly 11 years, during which mass unemployment has never budged below 8%, France's wealth per person has been overtaken by both Britain's and Ireland's, and public debt has jumped from 55% of GDP to 66%. The liberal instincts he once betrayed as a reformist prime minister in the mid-1980s have long since evaporated. His support for the prime minister's new jobs contract has been tepid at best. His chief preoccupation seems to be to avoid shaking the conservative French consensus, and even that unambitious objective has been missed. It is a measure of how wasted his presidency has been that one of his own ministers, Nicolas Sarkozy, and a 2007 presidential hopeful, can today make speeches that deplore “two decades of immobility” and call for a “rupture” with the status quo.

But the president is not to blame alone. Nobody on the French left dares to challenge the prevailing paleo-socialist wisdom, and Ségolène Royal, the most popular of the would-be presidential candidates, was roundly derided for confessing faint admiration for Britain's Tony Blair. On the right, Mr de Villepin at least had the courage to try to counter the logic of job protection, but elsewhere has scarcely demonstrated an embrace of open markets. Perhaps the closest France has to a new-generation leader prepared to try to reconcile French public opinion with globalisation is Mr Sarkozy. This week he declared that France could no longer “maintain the illusory barrage of a so-called model that each day shows itself to no longer work, nor protect anything or anybody”. But even Mr Sarkozy has proved a hard-core national protectionist when it comes to special pleading by French industry. All the while, he and Mr de Villepin's obsessive rivalry over the succession continues to sap France's ability to get policy right.

History will judge France harshly if its political class fails to find the courage to help the country equip itself for the 21st century. More than that, France's turmoil has implications beyond its own borders. An uncertain France is an uncertain partner for its allies, both in Europe and beyond. Within the EU, having rejected its draft constitution last year, the French no longer seem to know what they want. They still seek to project their influence through Europe, but will have difficulty doing this while they are so consumed by internal strife at home, and while they still struggle to come to terms with Europe's internal market. Can countries like Ukraine or Belarus be blamed for wondering what Europe can offer them while France, a founder member, is so unsure itself? The worry is that the more that France struggles to define a role for itself in the world, the more it will in turn be tempted to fasten on its social model as its raison d'être, and so cling to a discredited creed.

The choice belongs to France. A bold effort at renewal that could unleash the best in the French? Or a stubborn defence of the existing order that will keep France a middling world power in economic decline? The latter would inspire neither admiration, nor terror, nor hatred, nor indifference, just pity.

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The United States and Mexico

Sense, not Sensenbrenner

Mar 30th 2006
From The Economist print edition

Settling America's migration row requires a stronger NAFTA as well as wiser legislation

Reuters

Get article background

IN AN ideal world, there would be no barriers to immigration, just as there are increasingly few to the free movement of goods and capital. It is intrinsically repugnant, as well as inefficient, that some people can travel freely almost anywhere while others cannot. Migrants are usually enterprising people, who enrich their new countries as well as themselves. That is the philosophy on which the United States, in particular, has been built. “Understand what made America,” George Bush reminded the Senate this week, as it considered proposals to reform or restrict immigration.

In the real world, rich democracies try to manage the flow of immigrants. That is because people, unlike widgets or dollars, bring their own culture and complications with them. The United States, with its long border with Mexico where wages are barely a fifth as high, faces a particular challenge. More than 11m migrants are reckoned to be in the country illegally, with another 500,000 entering each year. Four-fifths of them were born in Mexico or elsewhere in Latin America, reckons the Pew Hispanic Centre.

This flow has become an increasingly charged political issue, and not just along the border. It has set House against Senate and divides both Republicans and Democrats. To his credit, Mr Bush has long supported rational reform of immigration law. But in this, he does not command his own party.

Opponents claim that migrants get more back in services than they pay in taxes. Most are unskilled and, it is argued, have depressed wages at the bottom of the pile. Some Americans feel threatened by an “invasion” of Spanish-speakers from next door. Most sensitively of all, since the terrorist attacks of September 11th 2001, Americans are alarmed that their territory can be penetrated with relative ease. Such thinking has energised the nativists in the Republican Party, who sense the issue is a vote-winner in the mid-term election.

In December, the House passed the Sensenbrenner bill. This would make illegal immigration a felony, make it a crime for anyone (including their own families) to help illegal migrants, and vote money to build a wall along much of the border. This bill would be not just divisive but even less enforceable than current laws. Its harshness has prompted a reaction, and not just in Mexico. On March 25th, some 500,000 took to the streets of Los Angeles while smaller protests took place in other cities. Note that the demonstrations were bigger than any so far mustered against the war in Iraq.

Opponents of the Sensenbrenner bill include an unlikely alliance of business groups, the Catholic church and Latinos. They make several points. One is that it makes no sense to criminalise hard-working families. Another is that immigrants have helped to make American businesses, farms and factories more competitive by doing jobs that natives are increasingly reluctant to do. The Congressional Budget Office reports that migrants have cut the wages of the shrinking number of native high-school dropouts by anywhere between zero and 10%, but that any fall may not be permanent. Latinos do assimilate, albeit more slowly than some other migrant groups. Lastly, *el norte* is no soft touch: more than 400 Mexicans died last year trying to cross the border.

Build roads not walls

Many senior figures in both parties, ranging from John McCain on the right to Ted Kennedy on the left, favour the kind of compromise espoused by Mr Bush. In the Senate Judiciary Committee on March 27th, they prevailed. By 12 votes to six, they approved a bill that would combine tougher border enforcement with a scheme under which existing illegals could obtain a visa and, eventually, citizenship. A further 400,000 visas would be issued each year for new arrivals. This is probably about the best compromise that could be reached, although its passage by the full Senate, let alone a conference of both houses, is far from certain (see article).

To make such a scheme work, Mexico's co-operation would be important. Hitherto, Mexican governments have been unwilling as much as unable to prevent the flow of their own people across their northern border, or of Central and South Americans across their southern frontier. The visa scheme gives Mexico more of an incentive to do so.

So Mr Bush had something to show when he flew to Cancún for a meeting on March 30th and 31st with Mexico's Vicente Fox and Stephen Harper, the new Canadian prime minister. But the leaders should recognise that faster economic growth in Mexico would do more than any legislative fix to take the heat out of America's immigration argument.

When the North American Free Trade Agreement (NAFTA) came into force in 1994, it was hoped that Mexico's economy would quickly converge with the United States. That hasn't happened. In the late 1990s, Mexico's GDP grew half as fast again as America's. No longer. China has partly displaced Mexico as a supplier of low-wage manufacturing. Nowadays, Mexico creates decent jobs for only around a quarter of the 800,000 who join its workforce each year.

The main way to change that is for Mexico's next president, who will be elected in July, to push through long-delayed reforms of taxes, energy, labour and competition laws. But there is one way the United States could help. Lack of roads and railways mean that the benefits of NAFTA have been largely confined to northern Mexico, rather than the poorer centre and south where most migrants come from. A North American infrastructure fund—in which the United States matched Mexican investment—makes much more sense than spending money on a border wall. In the long run, a richer Mexico means a richer and more secure United States.

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China's exchange rate

Yuan step from the edge

Mar 30th 2006
From The Economist print edition

America's obsession with China's exchange rate is largely wrong-headed

Get article background

ONLY a brave man or a fool predicts exchange rates. Regrettably, predicting exchange-rate policy is a different matter. America looks determined to press China to raise the yuan's value against the dollar ahead of President Hu Jintao's visit to Washington, DC, on April 20th. Such political games are understandable, given the mid-term elections coming up in November. But they are also dangerous. China's exchange rate is not to blame for America's huge current-account deficit. Moreover, by slapping tariffs on Chinese goods, as congressional bills have threatened if the yuan is not adequately revalued, America would mostly be harming itself.

The American government is frustrated that since the yuan was revalued by 2.1% against the dollar last July, it has risen by only a further 1%. Strong hints from America's Treasury suggest that its half-yearly report on exchange rates, due in April, could well brand China a currency manipulator. That, in turn, would open the door to American legislation to impose tariffs on Chinese goods. The Senate was this week due to vote on a bill proposing a 27.5% tariff on all Chinese goods. Although the vote has been postponed, another more modest bill would also force the administration to act against China. One way or another, Congress is likely to pass some legislation aimed at China's currency before the November elections.

However, it is worth examining the case for a big revaluation of the yuan. That America ran a trade deficit of $202 billion with China last year may seem like conclusive evidence that China's exchange rate must be massively undervalued. But China has accounted for only one-third of the increase in America's total deficit over the past five years, making the focus on China alone unfair. Moreover, the main reason for the increase in America's deficit with China is that since joining the World Trade Organisation in 2001, China has become an attractive place in which to assemble goods that were previously made elsewhere in Asia. Chinese exports have replaced those from countries such as South Korea and Taiwan, and so America's widening deficit with China has been offset by a falling deficit with the rest of Asia. Although China runs a large trade surplus with America, it runs deficits with other Asian countries from which it imports capital equipment and components. Thus China's overall trade surplus last year of $102 billion was only half the surplus that China runs with America. The latest indications are that the overall trade gap is likely to shrink this year.

American congressmen claim that the yuan could be undervalued by 30% or more against the dollar, but many private-sector economists reckon that it is probably only 10-15% too cheap. Moreover, while the yuan has barely risen against the dollar since July, the dollar itself has been strong. Thanks to that, in trade-weighted terms the yuan climbed by 10% last year (see article). In any case, a revaluation of the yuan by itself will not do much to reduce America's trade deficit. China accounts for only 10% of America's total trade, so a 10% revaluation of the yuan would reduce the dollar's trade-weighted value by only 1%. And most of the goods that China exports, such as toys, shoes and office machines, are no longer made in America. If America does not buy them from China, it will import them from somewhere else.

Stabbing oneself with chopsticks

Not only would a rise in the yuan fail to dent America's trade deficit, but imposing tariffs on Chinese goods would hurt America's economy by more than China's. Consumers who enjoy cheap clothes and televisions would be the biggest losers, along with multinational companies. Two-thirds of all China's exports come from non-Chinese firms—including American ones. China would retaliate with countervailing duties on American products, and American firms in China could face sanctions. Even if tariffs shut down the trade with China, America's trade deficit would still loom large as imports shifted to a higher-cost producer.

The main reason why neither a revaluation of the yuan nor trade restrictions will slash America's external deficit is that the real cause of that deficit is that the country consumes too much and saves too little. A change in the yuan's exchange rate will not by itself alter this fact. Indeed, from this point of view, China's exchange-rate policy

has arguably helped America in recent years, rather than hurting it. Cheap imports have held down inflation and hence interest rates. China's vast purchases of American Treasury bonds—designed to hold down the yuan—have kept long-term bond yields lower than they otherwise would have been. Cheap money has, in turn, fuelled the house-price boom that has supported consumer spending even as real wages have stagnated (admittedly partly due to Chinese competition). If China allowed the yuan to rise faster against the dollar it would need to buy fewer Treasury securities, pushing up bond yields. Worse still, if America is foolish enough to restrict Chinese imports then China might dump some of its dollar assets. A country with the biggest external borrowing needs in history surely cannot afford to snub its creditors.

China is not blameless in this affair. To ease frictions it could protect intellectual property, improve access for American firms in Chinese markets and push ahead with measures to boost domestic consumption and hence imports. But America is not blameless either. It has done little to boost national saving by addressing its reckless fiscal policy. America would be in a much stronger position to lecture China over its currency if its own economic policies were in good order.

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Car industry

A three-point turn

Mar 30th 2006
From The Economist print edition

What Detroit can learn from DaimlerChrysler's merger

Landov

Get article background

CYNICS might say that Chrysler is good at coming back from the dead only because it has had so much practice. Yet, as Delphi and the United Auto Workers (UAW) act out their dance of death weeks before a ruinous strike, and General Motors and Ford confront the demons that have plagued them for the past 20 years, DaimlerChrysler has a more positive lesson for the world's struggling carmakers. A decade ago Chrysler's bosses saw the future of the world car industry and realised the best chance of survival lay in the warm embrace of a foreign partner. By contrast, the foreign affairs of GM and Ford have been catalogues of failing, over-stretched imperialism.

Chrysler is the healthiest of Detroit's Big Three car companies these days, even though it still faces grim challenges in the American market. It has got there through foresight, discipline, good management—and plenty of mistakes.

Global Eaton

Chrysler's health today is no accident. Eight years ago it was rescued by Germany's Daimler-Benz, its third return from the brink in two decades (see article). Uncle Sam saved it in 1979, with a loan guarantee. A product-led revival, inspired by legendary car-industry figures, chiefly Bob Lutz, did the trick again in the early 1990s. For a moment in the mid-1990s Chrysler was the most profitable car company in the world. But its then boss, Bob Eaton, realised that it did not have the scale to slug it out. Antitrust concerns ruled out a domestic rapprochement with Ford, hence his pursuit of Daimler.

What Mr Eaton spotted early was that the car industry was no longer regional. He knew that America alone was not enough. Chrysler's 1990s glory days were thanks to its lead in booming markets for minivans and off-road sport utility vehicles—and, because of the cost of new designs, that could not last. Although GM and Ford had for decades owned international operations, they had never succeeded in exploiting the scale this gave them. Instead, they were a collection of regional baronies owned by a parent back in Detroit.

But globalisation was not simply an opportunity to harness economies from far-flung empires. It was also a challenge propelling fresh, lively competitors into the Big Three's own backyard. European, Japanese and South Korean carmakers were starting to design cars to American tastes and building cars in American factories. The plants that Honda, Nissan and Toyota (and later BMW, Mercedes and Hyundai) opened in Detroit South—the belt of southern states beyond the reach of the Michigan labour market ruled by the UAW—inherited none of the high wages and benefits that add thousands of dollars to the cost of each vehicle.

Detroit has been pathetically slow to adapt to the tide of globalisation lapping at its feet for the past 20 years. But Chrysler teaches more than the virtues of being early to a trend. The Germans took over Chrysler, but left local managers in place to avoid any anti-foreigner backlash. This was very nearly their undoing: the hands-off approach

may have saved face in Detroit, but problems went unnoticed. Barely two years after the merger, Chrysler plunged heavily into loss and DaimlerChrysler back in Germany had to put its scruples to one side, sack Chrysler's American managers and move a hit squad from head office to sort out its American acquisition.

This was a surprise. Chrysler had been a leader in adopting many Japanese business practices from the likes of Toyota. Cross-functional teams rapidly designed its products, its cars were planned for simple, cheap manufacturing and its factories had adopted Toyota's lean techniques. But when the Germans moved in, they found that Chrysler's managers had grown complacent after the recovery in the 1990s. While spendthrift Chrysler was pouring money into investment, basic disciplines such as cost and quality were being neglected.

Chrysler had to do one more thing besides facing up to globalisation and relearning elementary management disciplines. The new arrivals from Germany also had to overhaul the company. They shook up its product development, creating a range of new models playing to its brands, such as Jeep. The result was a big saloon car called the Chrysler 300 that has taken the market by storm and brought status to other models, built using the same (partly German) technology.

Along the way, Chrysler's German bosses have managed to shrink the company, shedding 45,000 jobs and closing six factories to bring capacity into line with the cars the company can sell—rather than the number it recalls selling back in the golden days. This points to the hardest lesson of all. Such relentless, detailed management takes a long, long time. And that is why Ford and GM are now paying such a high price for having been so slow to grasp the scale of the task.

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Valedictory

A long goodbye

Mar 30th 2006
From The Economist print edition

Bill Emmott, who stands down as editor on March 31st, offers his parting thoughts

REX

WITH April Fool's Day as the publication date on my final issue as editor, it is tempting to pretend that my resignation was just a joke, such is the privilege of presiding over *The Economist*. But after 13 years in the most interesting and satisfying job in journalism it really is time for a change, both for me and for this paper. Departing editors are allowed, however, to give themselves one final consolation: a signed, valedictory editorial as an occasion for some reflection, some explanation, much self-indulgence and usually a little ancestor-worship. The first thought of a departing editor is to abolish this ancient tradition. The second is to leave that decision to his successor.

It seems fitting to begin with the ancestors. One of the exceptional characteristics of this newspaper is the degree to which it still follows the principles and methods begun 163 years ago by its founder, James Wilson, and perfected by his son-in-law, Walter Bagehot. *The Economist* was launched to campaign for free trade and all forms of liberty, what proponents and detractors alike today call globalisation, blended with what George Bush likes to call “the freedom agenda”. It did so with a formula that was three parts factual description and one part strongly held opinion or argumentative analysis. That is what we continue to attempt today.

We do not do so merely out of loyalty to our founders: if those principles had turned out to be wrong, they would have been ditched long ago. And their application must always evolve. I, for one, had Bagehot grumbling in his grave when, in 1994, we declared the British monarchy to be “an idea whose time has passed”, in flat contradiction to his great 1867 book, “The English Constitution”. But in general what is striking about the past 13 years is how strongly this period has fitted Wilson's original view, how it made his principles feel more relevant than ever, and how in some respects our world is one whose issues he would have recognised.

The unstupid economy

To a degree, it is hard even now, in 2006, to recognise the world of 1993: a time when the Soviet Union was fresh in the memory, when China's development remained in the shadow of Tiananmen, when America was thought militarily powerful but economically passé, when few had mobile phones, e-mail was in its infancy and the internet was strictly for nerds. Yet the potential was there for the spread of economic development to what were newly known as “emerging markets”, emerging from communism, autarky, war or hyperinflation, and also for the spread of democracy to those same benighted lands. It was there too for a wave of technological innovation analogous to that brought by the railway boom, the electric telegraph and the steamship in the early decades of Wilson's *Economist*. The phrase “irrational exuberance” may not have been familiar to him, but the word “bubble” assuredly was. Just as early editors devoted thousands of words to a 19th-century version of Arthur C. Clarke's famous observation that the effects of technological innovations are typically overrated in the short run but underestimated in the long run, so did we.

The economic and political impact of the liberalisation of domestic and international markets for goods, services, technology and capital—globalisation, in short—is only just beginning. But it would already bring delight to Wilson's eyes. In 1993 overall growth in real world GDP was 1.2% and annual inflation was running at almost 35%. Things looked glum in the rich world and decidedly difficult in the poor world. Yet over the whole 13 years of wider competition and spreading liberalisation, the annual average rate of real GDP growth was 3.0%, and total growth over the period was about 45%; the figures rise to 3.9% and 65% respectively if you weight national GDPs to account for purchasing power differences between countries (known as PPP). Inflation, measured for the globe as a whole, slowed dramatically to reach 3.7% in 2005. World population increased by more than 18% during the period, but world GDP per head—a proxy for living standards—rose by nearly 40% on a PPP basis, at an annual average rate of 2.5%.

Progress on poverty

Economic statistics bemuse and baffle in equal measure. What matters is the human effect, and in that regard nothing matters more than the reduction of poverty. On that, there has been progress but far from enough. According to the World Bank, the proportion of the world's population living on $1 a day or less was 22% in 1993, or 1.2 billion people. By 2001, the proportion had fallen to 17.8%, or just over a billion people. Detractors wave even this aside by saying it is “just Asia”. Well, it is true that Africa is the continent that has tragically had regress, not progress, because of war, the ravages of disease, and decisions by too many governing elites to stick to kleptocracy. But given that “just Asia” takes in half the world's population, we should still be encouraged by what has happened. Martin Ravallion, a poverty expert at the World Bank, estimates that if present trends persist the number living on less than $1 a day will have dropped to a little over 620m by 2015, or about 9% of world population.

But will they persist? Plenty of people would like to stop them, even some who think they care about poverty. In much of the rich world, globalisation is seen as a threat, to jobs, incomes and the environment. On jobs at least, the facts suggest the opposite: unemployment in the OECD countries in 1993 was 7.8% of the workforce; on the latest figures it is 6.3%. What has occurred, though, is an increase in inequality within the rich countries. The huge expansion of the global labour force represented by the liberalisation of China and India has held down the incomes of the unskilled in all countries; the spread of information technology has had the same effect. The politics of that inequality is finding expression in the rise of economic nationalism in Europe and America.

Protectionism is always a danger and always will be: those who lose out from competition make louder noises about it than the more dispersed, albeit larger groups who gain. It will feature strongly in America's congressional elections in November, it already lies behind the roadblocks being laid in Europe and America against foreign takeovers, and is even being expressed in China itself (see article). Deplorable though all such protectionist lobbying is, however, it does not currently pose a serious threat to globalisation. The economic forces in favour of liberalisation remain strong. The most serious threats lie in the murkier world of international politics.

From Belgrade to Baghdad

There, too, the facts reassure. By the reckoning of Freedom House, a think-tank, 20% of the world's population in 1993 lived in countries that were fully free, in terms of political rights and civil liberties, and a further 40% in countries that were partly free. By last year the fully free had risen to 46% of global population. Full democracy has thus been spreading quite rapidly, even if it has sadly not yet reached China.

Other things spread too, during the past 13 years, and they were not nearly as reassuring. As my editorship began, war raged in the former Yugoslavia: whether it was civil, or regional, or ethnic, or religious hardly mattered to the hundred thousand or more who died. The question that hung over editorial after editorial was whether, or when, the outside world should intervene with military force. We argued that western intervention would not end the conflict, certainly not unless ground troops were sent in, and that it might make things worse. When NATO's second bombing campaign began, in 1999, our cover headline was “Stumbling into war”. Things turned out much better than we expected. That intervention cost some civilian lives but saved many more, as did the earlier one in 1995. The aftermath has shown how difficult it is for outside powers to rebuild the institutions of other countries and to repair the psychological wounds that war leaves behind. But that does not mean it should never be attempted.

1993 was also the year of the first attempt by al-Qaeda to blow up the World Trade Centre in New York, a failure that was followed by murderous successes in East Africa, Yemen and elsewhere, culminating in the atrocity of September 11th 2001. The West left Afghanistan alone in the misery of its sovereignty, which provided a home for Osama bin Laden and his training camps. Meanwhile it dealt with the legacy of the first Gulf war against Saddam Hussein by trying to use sanctions and no-fly zones to contain him, and UN inspectors to police his weapons ambitions. That process led to alarming discoveries, to bombing raids that killed Iraqi civilians, to the deaths of perhaps half a million Iraqi children, to the maintenance of America's air bases in Saudi Arabia, to a deterioration of the West's reputation in the Muslim world—and to Saddam and his sons remaining comfortably in power.

All of which is the background to the most controversial decision of this editorship: the decision to support the American-led invasion of Iraq in March 2003. Our reasoning began with the fact that the status quo was terrible: doing nothing, whether about Iraq or about the Israeli-Palestinian conflict, was itself a deadly decision. It went on to the risk that Saddam still had a stock of weapons of mass destruction that if left in power he might wish to use or to sell. In the light of September 11th and the dismal results from 13 years of sanctions, we argued that wishful thinking about Saddam would be reckless. The West should invade, remove him from power, and throw its considerable resources behind the rebuilding of a free Iraq.

The ensuing three years, I hardly need to say, have seen a debacle. His WMDs turned out to be a bluff, fooling even his own generals. Elections have been held, a constitution has been written, but no government is in place. Institutions remain in tatters. Whether or not a civil war is under way is largely a semantic issue. Dozens of Iraqis are dying every day, killed by other Iraqis. So does this prove our decision wrong, just as the good outcome in ex-Yugoslavia put our “stumbling” warning in the shade?

This will outrage some readers, but I still think the decision was correct—based on the situation at that time, which is all it could have been based on. The risk of leaving Saddam in power was too high. Outside intervention in other countries' affairs is difficult, practically, legally and morally. It should be done only in exceptional circumstances, and backed by exceptional efforts. Iraq qualified on the former. George Bush let us—and America—down on the latter. So, however, did other rich countries: whatever they thought of the invasion, they had a powerful interest in sorting out the aftermath. Most shirked it.

The only argument against our decision that seems to me to have force is that a paper whose scepticism about government drips from every issue should have been sceptical about Mr Bush's government and its ability to do things properly in Iraq. This is correct: we should have been, and we were. But when the choice is between bad options and worse ones, a choice must still be made. Great enterprises can fail—but they fail twice over if they take away our moral courage and prevent us from rising to the next challenge.

Of principles and politics

The incompetence of the state-building exercise in Iraq since 2003 does, however, leave not only Iraq in a dangerous state but also the world. Its failure so far to provide either security or legitimacy has turned Iraq into a cause célèbre and a training ground for violence. Worse, it has made the world's only available policeman look weak, which encourages other troublemakers, and has undermined the cause of international engagement in both America and Europe. And the very principles that Mr Bush says he is fighting for—democracy, human rights—have been undermined by the appalling injustice of Guantánamo Bay and other extra-judicial detentions.

The juxtaposition described in this editorial, of economic progress with political fractiousness and conflict, could lead to a sanguine conclusion. Even the war in Iraq, even oil at $60-70 a barrel, cannot halt the march of globalisation. But that would be wrong. Globalisation, and the progress against poverty that it brings, will be halted if politicians decide that the costs of openness exceed the costs of isolation. A failure in Iraq, and with it the spread of conflict elsewhere in the Middle East, could tip that balance. An even more decisive tipping would come from the use by terrorists of some form of WMD, supplied by someone emboldened by Iraqi chaos. Another candidate could be a miscalculation by a bigger country elsewhere—China, say, over Taiwan—of the opportunities provided by American weakness and transatlantic divisions.

Are these thoughts more apocalyptic than realistic? History suggests not. In the early 20th century, embryonic globalisation was suffocated not by economics but by politics; and the consequence was the bloodiest century the world has ever known. That's why this departing editor wishes fervently that his successor's time will see a redoubled American effort in Iraq, a revival of help from other countries in dealing with that conflict and with others, and a firm acknowledgment by politicians everywhere that the case for international engagement and openness needs to be made continually. It will certainly be made by *The Economist*.

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On philanthropy, Germany's railways, democracy in America, standby power, Brazilian reading habits

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Donating to the argument

SIR – I must take issue with the distinction you made between the old and new type of philanthropist in your survey of wealth and philanthropy (February 25th). You wrote as if it were only the newer breed of philanthropists who support innovative ideas and have a genuine desire to be part of the projects they fund. I have spent the past 25 years as the senior development officer at New York University and I never received a gift—whether it was from Larry Silverstein, Leonard Stern, the Tisch family, Phyllis Wagner, or any of the other "older" types of philanthropists—without the donor wanting to be involved in a project and asking for regular reports on how their money was being used.

Moreover, what does it mean to say that the new philanthropists want to make the non-profit sector as efficient as private business in America? Should philanthropy become more like General Motors? Or the airline industry? Or agriculture, which requires government subsidies to make a profit? Should the sector follow the business models of Enron? Or WorldCom? I do not think that charities need to look towards business for lessons on ethical behaviour.

Naomi Levine
Chair and executive director
George H. Heyman Jr Centre for Philanthropy and Fundraising
New York University
New York

SIR – John Studzinski of HSBC states that of all London's homeless projects "only eight are any good". This suggests a complete lack of understanding about the issues involved with homeless people themselves and of the voluntary sector, which is enhanced precisely because of the diversity of its projects. Local groups often meet a need that homogenised and centralised groups cannot. We run a small homelessness project which secures long-term accommodation for over 150 people a year. Volunteer households help us by taking homeless people into their homes for a period of time while we find solutions, often in the private sector, to their predicament. Is Mr Studzinski telling me that this type of project, which looks after homeless people throughout the year, is not any good? Or are we one of his lucky eight?

Ian Joseph
Managing director
HOPE worldwide, UK
London

SIR – You mentioned the Kamchatka region of Russia as a recipient of philanthropic largesse from Roman Abramovich, a Russian oligarch. In fact, it is the Chukotka region where Mr Abramovich prefers to be generous with his fortune. Since the beginning of his governorship there, its population of 50,000 has benefited from a windfall of giving from Mr Abramovich and his corporate entities that has significantly improved living conditions in this remote corner of Russia's far east. Kamchatka, on the other hand, is still to find its benefactor among the oligarchs.

Roman Novozhilov
Washington, DC

SIR – My 12 years of experience as a professional fundraiser in Britain has taught me that few donors spontaneously decide to support a particular cause; charities certainly won't get far sitting around waiting for a potential donor to call. Like most things in life, philanthropy is usually sold, not bought.

Julian Marland
London

Track record

SIR – The claim that Deutsche Bahn, Europe's biggest railway, "is now free of the need for subsidy" is misleading (Face value, March 11th). Regional services are heavily subsidised by the *Länder*, and while Deutsche Bahn makes a handsome profit on them, this is only after subsidies are taken into account. And, of course, no railway in Germany has to bear the entire costs of infrastructure, since these are also subsidised. On the whole, the situation of Germany's railways is not as different as you make out from the one in Britain.

Patrick Segalla
Vienna

The roots of democracy

SIR – I read your leader calling for reform in redistricting congressional boundaries, but I must tell you that gerrymandering has been a significant part of American politics since the beginning of the republic ("Competition calls", March 18th). After the constitution was decided, Patrick Henry, an ardent Anti-Federalist, was so angry at James Madison for working with Alexander Hamilton to get the document passed that he denied Madison the Virginia seat in the Senate he wanted (state legislatures picked senators at the time). Henry, who controlled Virginia's legislature, also gerrymandered the state's congressional districts, ensuring that Madison's home was placed in a district with strong Anti-Federalist support when he eventually went to the House of Representatives.

Dean Riesen
Scottsdale, Arizona

SIR – The system of postal voting eliminates one of the great ceremonial occasions of democracy, where all citizens gather to vote. One used to go to the polls and find one's neighbours, great and small, rich and poor, all brought together to cast their ballots. With people now voting in their home, this democratic feeling will be lost and we are impoverished.

Paul Silverstone
New York

SIR – If California is so "dysfunctional", how do you explain that it has one of the most prosperous and progressive societies on the planet? Hundreds of thousands of immigrants and migrants from other parts of the United States flock there each year, seemingly undeterred by the horror of being allowed a direct vote on many of their laws. Nor, it would seem, have Californians themselves felt the need to use the initiative process to revoke their dysfunctional democratic rights.

Stephen Morris
Coorparoo, Australia

Keep plugged in

SIR – You make the assumption that all of the power being used by appliances that are on standby is wasted ("Pulling the plug on standby power", March 11th). It is not. Standby power ends up as heat and slightly warms a room. Most appliances are located in kitchens and living rooms, areas where people base their central-heating controls. Thus, lower thermostat settings reduce unnecessary heating in largely unoccupied rooms, such as bedrooms. Add the fact that standby power creates a constant base-load demand for electricity, met by the most efficient power-stations (often nuclear), and the indirect result may be a net reduction in greenhouse-gas emissions.

Edward McWilliam
Bratislava, Slovakia

A leisurely read

SIR – So Brazilians read 1.8 books a year, which takes them 5.2 hours a week to complete ("A nation of non-readers", March 18th). Elementary arithmetic suggests that Brazilians take 150 hours to read a book. Perhaps the problem lies with the way reading is taught in the country. Either that or the books most Brazilians read must be weighty tomes like "Remembrance of Things Past".

John Kehoe
Tecumseh, Canada

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France's troubles

A tale of two Frances

Mar 30th 2006 | PARIS
From The Economist print edition

MAXPPP

A war may be needed to bring the two together, but this is not the right battle

Get article background

A FAMILIAR story is once again grabbing headlines in France. In March, the Paris bourse soared to its highest level since 2001. Latest financial results show record profits for the country's top 40 companies in 2005, up 50% on 2004. Last year, French companies were the world's third-biggest source of global cross-border takeovers. From banking to telecoms, cosmetics to glassmaking, corporate France is in expansionist mood, gleefully striding into new markets, trampling over competitors and exploiting the globalised economy.

Not exactly the image that France is currently beaming around the world. Some 1m-3m people took to the streets on March 28th in the biggest single day of strikes and demonstrations that the country has seen for well over a decade. Train drivers, postmen, teachers, tax inspectors, gas and electricity workers and civil servants joined the work stoppage, in protest against a new labour law, bringing chaos to cities across France. For most of the day, the mood was more festive than hostile, with protesters blowing whistles, beating drums, wearing orange wigs or rollerblades; one was dressed, bare-breasted, as Marianne; one carried a lavatory seat with a photo of the prime minister, Dominique de Villepin, pasted inside.

In Paris, the streets filled with students and trade unionists, and then with smoke and tear gas, as riot police tried to contain the violence that broke out later at the Place de la République. Some 488 people were arrested in the capital, most of them troublemakers rather than students. Only days earlier, a previous day of protest that also turned nasty ended with torched cars in a posh bit of central Paris. Since the start of March, nearly 500 policemen have been wounded in the demonstrations, more than during last autumn's riots.

Tuesday was the culmination of a seven-week protest against the *contrat première embauche*, a private-sector "first job contract" for the under 26s, known in France as the CPE. It was devised by Mr de Villepin to try to combat mass unemployment in France, which touches 23% of young people, and one in two of those living on the rough housing projects in the *banlieues* or suburbs. The idea was to encourage employers to create jobs, particularly for ill-qualified youngsters living on such estates, by giving them a two-year trial period during which flexible redundancy rules apply, after which full job protection kicks in. Students, however, denounced the measure as "institutionalising insecurity" and victimising the young. What started as a student-led anti-CPE protest has since broadened into a symbolic stand-off with Mr de Villepin: a pre-emptive protectionist strike.

Mr de Villepin has handled this effort to introduce more labour-market flexibility with lamentable imperiousness, pushing a bill through parliament by decree without consulting the unions or allowing a full debate. But the underlying confrontation he has provoked is overdue: the need for France to face up to, and accept, global capitalism. For what unites the trade unionists and civil servants (most of whom are untouched by the new

contract) and the students (many of whom will be over 26 by the time they reach the job market) is an overwhelming conservatism: a desire to cling to an idealised world of jobs for life that their parents used to enjoy, combined with a denial of the constraints that a globalised economy imposes.

Yet the paradox behind the current turmoil is that this France, which cowers before the threat of globalisation, co-exists with the other—the dynamic, highly trained, private-sector France—which is marching brazenly wherever globalisation allows. These are the two halves of today's France, which inhabit quite separate worlds, which speak quite different languages and which, almost uniquely in Europe, seem to be drifting farther apart.

Protesters v investors

When Mr de Villepin recently sought a meeting with some calm-minded non-revolting students, his options were pretty slim. The national student unions refused to talk to him. A swelling student rebellion had already led to campus sit-ins and blockades at over half the country's 84 universities. So where could Mr de Villepin find the amenable sort? The answer was a quick walk down the road from Matignon, the prime minister's mansion, to the Paris Institut d'Etudes Politiques, known as Sciences Po. Students at this elite internationally minded college, whose alumni include Mr de Villepin, were quite happy to chat to the former pupil, fully aware of what is at stake for France.

One of the arresting features of the current student movement is how little it has touched France's *grandes écoles*. Sciences Po, a feeder college for these elite schools, has seen nothing of the violence or forced blockades of nearby Paris universities, such as the Sorbonne. Nor have most of the country's top undergraduate business or engineering schools, such as Polytechnique, HEC or ESSEC. Students at such places, taught the latest in finance and economics, understand the price France will pay if it refuses to change. These are the well-trained graduates snapped up by banks in London and New York which are only too happy to benefit from what France does best, and by those French companies now busy exploiting globalisation with such aplomb.

These two faces of France are separated early in the country's two-tier higher education system. At the top, the *grandes écoles* cater to a small minority and are highly selective: would-be pupils spend at least a year in a preparatory class just to take the entrance exam. While the Ecole Nationale d'Administration (ENA) is the best-known (and arguably the least well-adapted to the global economy), it recruits only a tiny share of the total. The rest are autonomous, and highly specialised in areas such as engineering or business. And employers pay a premium to hire their graduates. A recent study by *Le Nouvel Observateur* magazine showed that 96% of graduates from top engineering schools were placed two years later in permanent jobs, earning an average of €30,400 ($36,600). By contrast. only 45% of university psychology graduates had found permanent jobs by the same stage, and their average income was €19,000.

The majority of students attend universities that do not select on entry and are virtually free (fees are currently under €200 a year). Any school-leaver with the *baccalauréat* is granted a place. Students are packed into overcrowded lecture halls: France spends less per undergraduate each year than it does per high-school pupil. Lecturers are civil servants, employed by the national Ministry of Education. Universities have little autonomy. And much research is done elsewhere, at the national research institutes. Little wonder that France's undergraduate drop-out rate is about two-fifths and that, in the latest global ranking by Shanghai's Jiao Tong University, not a single French university appeared in the top 40.

If the *grandes écoles* students have little to worry about, university students are right to be fearful. Young French people not only face a woefully high unemployment rate, they also find it difficult to break out of a cycle of back-to-back short-term contracts. Over 64% of French 15-24-year-olds in work are on temporary contracts one year after leaving education. The reason that these jobs are the best on offer is that permanent jobs are so protected, with complicated and uncertain redundancy rules, that employers hesitate to hire. This is precisely why Mr de Villepin wanted to loosen the firing rules for the young.

The potential trade-off—between less security and more jobs—is not the way the students see it. Nor does public opinion: polls show a majority against the CPE. Many of this week's demonstrators carried banners denouncing not just the new contract, but other liberal evils, such as globalisation and the free market. “I have never felt France so tense and tormented,” said Nicolas Sarkozy, the interior minister and head of the ruling UMP party. This fear for the future is what distinguishes today's student-led rebellion from that of a generation ago. “May '68 was an offensive movement, carrying a positive vision of the future,” Daniel Cohn-Bendit, the 1968 student leader turned Green Euro-politician, told *Paris-Match* magazine: “Today's protests are based on the defensive, the fear of insecurity and of change.”

Why do the French seem to fear capitalism? The country's republican revolutionary history bequeathed faith in a strong *dirigiste* state as a civic religion. Today, nearly 5m French workers, or one-quarter of all jobs, are still in the public sector. Left-leaning intellectuals, with a romantic communist heritage, are not derided but treated as national treasures. There is a lingering culture of suspicion of profit, and a demonisation of business leaders, encouraged by a mainstream left that still equates efficiency with injustice.

The Socialist Party, for instance, is committed to renationalising Electricité de France (EDF), the state electricity utility, which was partly floated last year. The Communist Party, with its hammer and sickle flag and its grip on the biggest trade union, the Confédération Générale du Travail, is considered part of the mainstream left. Only assorted Trotskyites and Revolutionary Communists earn a place on the fringe. As François Bayrou, a centrist political leader, once put it: “France has never been properly *déMarxisé*.”

Let's go for le Happy Meal

Yet are the French really as anti-capitalist as they like to think? Take a closer look at what they do, rather than what they say, and things seem a little different. When EDF was floated, over 5m French individuals snapped up the chance to become a shareholder. Vandals near the Sorbonne smashed the glass front of a McDonald's restaurant during the student protests, yet the French are calm about enjoying “le Happy Meal” with their children, and many students work there part-time. Indeed, the American group recently reported strong operating profit for the fourth quarter of 2005 based partly on its huge success in France. Many of the petty thieves infiltrating the current protests are out to snatch the latest Samsung or Nokia mobile telephones, fashion accessory of choice for students in France like anywhere else. The French, it seems, condemn capitalism during office hours, but are quite happy to consume its products at the weekend.

Within the private sector, the rules of globalised capitalism are well accepted. France is less unionised than America, and very few days are lost to strikes. Per hour, French workers are more productive than their American counterparts—though they lose out on overall productivity because, thanks to the 35-hour week, they work so few hours. And young French people snap up the loosely protected jobs in bars and cafés in London, the sort that are being protested about so vigorously in Paris.

Who then is to blame for the gap between the rhetoric and the reality? The short answer is a political class that has repeatedly failed to explain to the French what is at stake and why things need to change. For the past 20 years, the mainstream political choice has been between a form of socio-Gaullism embodied by President Jacques Chirac (who last year described liberalism as a greater threat than communism) and an archaic socialism that fails to understand, or at least to explain, that wealth needs to be created before it can be shared. Such reforms as France has carried out tend to have been introduced by stealth, both by the left and the right. Lionel Jospin, a Socialist ex-prime minister, for instance, managed to privatise whole swathes of industry without ever using the word.

The result, however, is that the credibility of the political word has been undermined. As Michel Camdessus, a former IMF director and author of a devastating criticism of the French model in 2004, put it: “Reform in our country still moves forward with its face masked. Certainly we take action, but we never say why.” So when Mr de Villepin promised last year to keep a 70% holding in Gaz de France (GDF) as a condition of its partial flotation, employees disbelieved him. Instead, they took to the streets to contest what they suspected was a first step towards privatisation. Sure enough, when Suez, a private French company, faced an expected hostile bid from an Italian firm in February, Mr de Villepin stepped in and orchestrated a merger with GDF—even though that will shrink the state's share to about a third.

Where was the politician ready to argue that a Franco-Italian merger could create a new European energy giant, rather than fend off outsiders at any cost? Why was there not a murmur when BNP Paribas, a French bank, marched into Italy earlier that month and picked up an Italian one? Or when L'Oréal, a cosmetics giant, recently snared Body Shop, an iconic British chain. Capitalism, judging by the rhetoric, is for the French only when it suits.

Were all this simply political theatre, it might be little more than a distraction. But the failure to explain is also a failure to create the consensus needed for reform. And the longer reform is postponed, the more painful it will be. The weight of the state, which raises too many taxes, to pay too many civil servants and implement too many rules, is already a drag on economic growth. The French government's overall tax take is 44% of GDP, next to a euro-zone average of 39.5%. The economy grew by a mere 1.4% in 2005, and is only slowly picking up this year. All the while, France is piling up unsustainable debt to prop up its sprawling welfare system. Michel Pébereau, chairman of BNP Paribas, pointed out in a government-commissioned report that if nothing is done about the government debt, it will soar from 66% of GDP today to 100% in 2014. The net result will be a “foreseeable reduction of our capacity to create jobs and wealth.”

To the barricades

How will the current stand-off be resolved? Mr de Villepin insisted this week that he was open only to “amendments” of the CPE, such as a shortening of the two-year trial period, but would not withdraw it. The unions

are also in no mood to give ground. “The government”, Pierre Lellouche, a UMP deputy, told *Le Figaro* this week, “is stuck between capitulation and collective suicide.”

EPA

Sarkozy (left) is smug that he would have done things better than de Villepin

In the short run, there seem to be only two ways out of this impasse that would enable Mr de Villepin to rescue at least a shred of credibility. Either the Constitutional Council might decide that the law is illegal in a ruling due on March 30th: Socialist deputies have filed an appeal on the grounds of “inequality”. Or Mr Chirac, who is expected to make a statement in the next day or two, could decide not to promulgate the law until the two sides decide to sit down and talk.

Even if the law is put on hold, and negotiations start again, the question about France's willingness to modernise will remain. Will France have ducked its “Thatcher moment”, the point when the country might have tested the union-led resistance and imposed liberal economics on a fearful public?

One trouble is that Mr de Villepin's CPE, while welcome, is not the radical liberal overhaul that the labour market needs and which would deserve this sort of confrontation. No change is envisaged to the high social charges employers pay for each employee, nor to the high minimum wage; redundancy rules for permanent jobs remain untouched. Nor is Mr de Villepin, a romantic idealist and part-time poet who admires Napoleon and de Gaulle in equal measure, a convincing liberal figure.

Which is why some reform-minded deputies fret that Mr de Villepin's war of attrition could make it more difficult for France to attempt anything genuinely radical in the future. Supporters of Mr Sarkozy, who like Mr de Villepin is an aspirant candidate at next year's presidential election (and who preaches a “rupture” with France's social model), tend to regard this as a fruitless trial run that is not worth the political capital. Mr Sarkozy has been careful to distance himself from the prime minister, calling early on for the CPE to be put on hold while negotiations take place.

Had the parliamentary party, and the government, been united behind the prime minister, this stand-off might have been avoided. But underlying the bungled CPE affair is the corrosive power struggle that pits the prime minister against his number two. Mr de Villepin's desire to force through the CPE was guided by his need to establish himself as a man of action, not just of letters, and therefore as a potential candidate for 2007.

Appointed only last May, he had little time to put his plans into place, and in his haste he failed to prepare public opinion or the unions for what he was trying to do. By treating parliament as a plaything, to be dropped at whim, and the unions as optional, he has ended up looking like yet another in a line of aloof political leaders exploiting a system of highly centralised power to impose their way.

Naturally, Mr Sarkozy has lost no opportunity to remind the French that he would have handled things better. “It is not change that the French refuse,” he declared in a speech this week, “but reform that they consider unfair.” As both men's popularity sink in the polls, however, the greater threat to both is not each other. It is that their self-destructive rivalry enfeebles the political right, and that, in 2007, the Socialists end up victorious.

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Immigration

Don't fence us out

Mar 30th 2006 | AUSTIN, MEXICO CITY AND PHOENIX
From The Economist print edition

Landmark Media

In a debate fraught with political peril, especially for the Republicans, will Congress emerge with a sensible solution?

Get article background

JAMES MADISON once described the Senate's role as “a necessary fence” against the “fickleness and passion” that could overtake the House of Representatives. The system seems to be working on the thorny matter of immigration, at least for the moment. This week, while House leaders called for ever higher barriers along America's southern border, the Senate Judiciary Committee approved a bill that would put the estimated 11m illegal immigrants in America on the road to citizenship, and allow many more in as guest workers.

That is broadly in line with George Bush's position; but pragmatic moderation is a relatively rare commodity when it comes to immigration, especially with mid-term elections looming. Republicans are badly divided. The House passed a bill in December that called for a crackdown on illegals, with no mention of citizenship or guest workers. Some provisions smacked of fanaticism: building a 700-mile wall along the border with Mexico; classifying illegal aliens as felons (currently, being in America illegally is a civil offence); and criminalising their helpers, which could, some say, hit the church workers who give them food and care.

Such harsh measures are exactly what many parts of the conservative movement and the Minutemen vigilantes (bands of armed citizens on America's borders) have been calling for. But the threat of such draconian action seems to have woken up the sleeping giant of American politics—Latinos. Some 500,000 people went on the march through Los Angeles (see article), and high schoolers have been skipping classes from Phoenix to Dallas to wave Mexican flags.

Immigration is one of the trickiest issues facing Congress, which helps explain why little has been done despite Mr Bush's initial hopes of prioritising it. Arrivals spiked shortly before his election in 2000, helped by the 1990s boom. Now the numbers, especially for illegals, are growing again. These days illegal arrivals outnumber legal ones, according to the Pew Hispanic Centre, with more than half a million sneaking into America each year. Most come through Mexico, jumping fences, hiking across the desert, or huddling together dangerously in truck beds. Hundreds perish each year in the attempt.

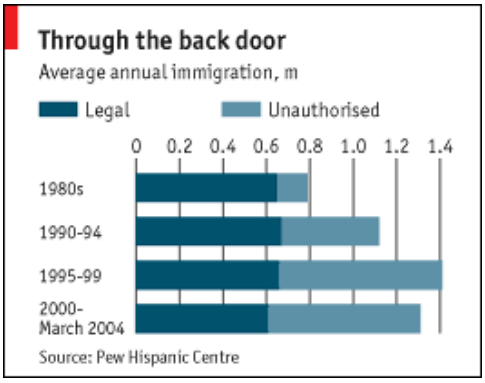
Border states, inundated with both migrants and drug trafficking, are seething. Arizona, for instance, is operating under a continuing state of emergency. Dennis Burke, chief of staff for Janet Napolitano, the state's Democratic governor, complains that the federal government has shown itself “completely inept” at protecting the border.

He has a point. America's border patrol has just over 11,000 agents; New York City's police force is nearly four times bigger. The border guards need better technology, as well as far more manpower. Turf battles within the

new Department of Homeland Security, and between it and local authorities, have made things worse. Border states are ploughing their own resources into protection—Texas's Republican governor, Rick Perry, recently pledged $10m—but it is nowhere near enough. To plug the security gap, volunteer Minutemen have started up—and plan new patrols on the Canadian border this month.

So how would federal lawmakers fix the problem? Under the Judiciary Committee bill, which was built on legislation drafted by Senators Ted Kennedy and John McCain, illegals who want to stay in America would have to pay a fine as well as learn English and continue to work. After several years of working, they could begin the process of applying for citizenship, though they would have to pay back taxes and get in line behind those who are seeking citizenship through a legal route. Hundreds of thousands more foreigners would be eligible for temporary "guest-worker" passes (with a special provision for temporary farmworkers in California). The bill would also add another 14,000 border-patrol officers, and more cameras and sensors along the border, though states are quick to point out that such niceties mean nothing until they are put into the budget.

The Judiciary Committee gave it bipartisan approval in a 12-6 vote. But the real wrangling is only beginning. Tamar Jacoby of the Manhattan Institute, a think-tank, predicts "a bit of a food fight" in the Senate over the shape of the final bill. Bill Frist, the majority leader who has an eye on a possible presidential run, started the Senate debate with his own bill, which, like the House version, emphasises enforcement.



Opponents of the McCain-Kennedy bill are deriding it as an "amnesty" for illegals. They point to a 1986 amnesty law, signed by Ronald Reagan, which handed green cards to nearly 3m illegals. Clearly, it (and its six successors) have not done much to stem the tide, and some officials in places along the border fear that rumours of a new amnesty could spur more Mexicans to rush across.

Mr Bush made a point of saying that he would "firmly oppose amnesty" in remarks that he made at a naturalisation ceremony this week. But he does back a guest-worker provision, which puts him at odds with some hardliners in his party (not to mention the labour unions). The president is due to discuss immigration when he meets the leaders of Mexico and Canada in Cancún this week. Mexico's president, Vicente Fox, says that "the ball is in America's court"—though he has also stressed that his government is not seeking any sort of amnesty, only a guarantee of a regular migratory flow.

Whatever comes out of the Senate will have to be reconciled with the House bill. This will be difficult. The House version is not wholly impracticable. For instance, it would force employers, such as restaurants and hotels, to check more rigorously the legality of the people they hire. Yet many of its proposals seem designed more with this year's mid-term elections in mind than any chance of being put into action. For instance, if America were really to turn 11m people into felons (which would be five times the number of Americans currently behind bars) it would clog up the criminal justice system. But tough talk on illegals will go down well with conservatives in the Republican primaries; and Democrats are already worried that, in November, immigration will distract attention away from Iraq and the deficit.

Two things could change the immigration debate profoundly. The first is Latino anger. America is bitterly divided over issues such as bilingual education, and whether illegals should be able to get driving licences. So far, rabble-rousing by Republicans such as Tom Tancredo, a Colorado congressman, has been rather effective in galvanising some nativist sentiment. But Mr Bush and his chief political adviser, Karl Rove, have spent years courting Latinos. Hispanics are not just the biggest minority in America; they are spreading out, no longer concentrated simply in border states—and their votes are up for grabs. Worryingly for Mr Rove, the hundreds of thousands of Latinos who took to the street this week seemed confused, scared and angry.

The other thing that could change the debate is terrorism. Although the September 11th hijackers entered the country legally, others could opt for the desert. Most of those sneaking in are from Mexico, but a rising number are from Central America and South-East Asia. In Arizona, there are reports of Iraqis, Syrians, Saudis and even Afghanis trying to cross. If anyone needed a reminder of the elusiveness of border security, Norm Coleman, a Republican senator from Minnesota, has just revealed that enough radioactive material to make two dirty bombs had been smuggled into America. It was a test, fortunately.

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California's Latinos

Making their feelings known

Mar 30th 2006 | LOS ANGELES
From The Economist print edition

But does that mean an anti-immigrant backlash?

Get article background

AP

On the march

WHAT brought 500,000 mainly Latino demonstrators onto the streets of downtown Los Angeles last weekend? Or sent 40,000 mainly Latino schoolchildren marching about the streets—even the freeways—of southern California this week? The cynical answer is that LA's Spanish-language radio stations proved to be far better at mobilising the masses than the anti-immigrant ranters of right-wing talk-radio. The underlying reason is the sensitivity of California's Latinos to immigration reform.

At present, Latinos in California number about 12m, a third of the state's population. Within 15 years they will outnumber whites. Just how many of them are undocumented is a matter of debate. Even if a Latino is a legal resident, or indeed, by virtue of birth, an American citizen, the chances are strong that he or she has some undocumented relatives. By one count, up to 15% of California's schoolchildren have “illegal” parents.

The rage against a House bill, passed last year, which wants to turn into a felon not just any illegal immigrant but also anyone helping that immigrant, is not limited to Latinos. Cardinal Roger Mahony, archbishop of Los Angeles, America's largest Roman Catholic diocese, has already said his priests will flout any such law. But it was the vigour of the Latino protest that stood out.

The politics are complicated. Costa Mesa, an affluent township south of LA, has instructed its police force to question immigrants on their legal status—and to arrest the illegals. This is contrary to the traditional view of the police, including the LAPD, that enforcing immigration law is a federal, not a state, matter. By contrast tiny Maywood, just south of downtown LA and with fewer than 30,000 inhabitants, 96% of them Latino, has vowed to protect illegals, even dismantling its traffic division, lest it interfere.

Back in 1994 Californians voted by 59% to pass Proposition 187, a ballot initiative that sought to deny health, education and social benefits to the undocumented. Later declared unconstitutional, it helped lead to an anti-Republican backlash in the state. But some local conservatives still think there is mileage in the issue. There are plenty of voters, regardless of race or origin, who resent the costs of illegal immigration. The Federation for American Immigration Reform (which lobbies for a limit) says that the bill for California's taxpayers is $10.5 billion a year, most of which goes on educating the children of illegal residents.

Arnold Schwarzenegger swept into the governorship in late 2003 partly because he promised to revoke his Democratic predecessor's promise to give driving licences to undocumented foreigners. With his movie-star persona, the Republican was initially popular with Latinos. But the driving-licence business undid this, as did his tactless comments last year in favour of the self-styled Minutemen who briefly took up positions on the border. Trying to repair the damage, he now seems to follow George Bush's line on immigration reform.

In the long term, of course, neither party can afford to alienate the Latino vote. At the moment Latinos are more likely (56%) to be Democrats, with 23% Republican and 21% independents. Together, they make up only 14% of likely voters (almost three-quarters of whom are white). But their voting weight is bound to increase and, because they tend to be conservative on social issues yet more leftish on fiscal and environmental ones, neither party can take their votes for granted.

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The White House

Card discarded

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Could this be the start of a big reshuffle?

Get article background

EVERYONE remembers the scene. George Bush was reading a book about a goat to a class of schoolchildren in Florida. An aide stepped up and whispered to him that a second plane had struck the World Trade Centre. The look on the president's face betrayed anxiety and, his detractors argue, confusion. What no one recalls is the face of the whispering aide. Mr Bush's chief of staff, Andrew Card, has held one of the most powerful jobs in American politics for five years without anyone really noticing. When he quit this week, the country shrugged and switched to the basketball.

His resignation may yet prove significant. Why he went is not clear. Mr Bush said it was because Mr Card thought it was “time to return to private life”, which sounds lame but is not implausible. Being chief of staff is an insanely demanding role: you have to act as gatekeeper between the president and everyone who wants to meet him while simultaneously keeping the executive branch in line and watching out for trouble from unexpected quarters. Mr Card reportedly got up at 4.20am and took calls until 11pm nearly every working day for half a decade. He lasted longer than any chief of staff since the more leisurely 1950s. Whatever he does next, he can expect less work, more money and more time with his family.

Was he pushed? Disgruntled Republicans have been grumbling for some time that the administration looks tired and in need of fresh blood. Mr Bush's inner circle rarely changes. Surrounding himself with people he has known since the early days in Texas may make Mr Bush feel comfortable, but his critics charge that it has starved him of fresh ideas and constructive criticism. The team's sheer exhaustion may have contributed to recent foul-ups—the sluggish response to Hurricane Katrina, the failure to predict that populists in Congress would object to an Arab firm managing American ports, and so on. Since it was part of Mr Card's job to spot trouble approaching, he could not avoid part of the blame.

Could Mr Card's departure mark the start of a big reshuffle? Some Republicans think it should. For example, Fred Barnes, an editor at the *Weekly Standard* and author of a generous biography of Mr Bush, set the chattering classes chattering in March with a suggestion that Condoleezza Rice be made vice-president, Dick Cheney demoted to defence secretary and Joe Lieberman, a hawkish Democrat, replace Ms Rice as secretary of state. But Grover Norquist, an influential anti-tax campaigner, says Mr Bush appears to have rejected such radical proposals, judging by his choice of replacement for Mr Card.

Joshua Bolten, Mr Bush's new chief of staff, has a few spots of colour on his curriculum vitae. He was a founder member of Bikers for Bush, was once seen with Bo Derek, a Republican-oriented film star, on the back of his metal steed, and plays in a band called Deficit Attention Disorder. But other than that, Mr Bolten is self-effacing, technocratic and an insider of long standing, having been budget director since 2003 and White House deputy chief of staff before that.

Kevin Hassett, an analyst at the American Enterprise Institute, a conservative think-tank, argues that Mr Bolten's appointment could mean the administration is planning to grapple with America's toughest economic problems, such as reforming its fairly-soon-to-be bankrupt entitlement programmes (Medicare, Medicaid and Social Security). But little action is likely until after the elections in November, he says. Unless of course somebody else gets discarded too. Then the chatter will begin again.

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George Bush and Olusegun Obasanjo

A close escape

Mar 30th 2006 | WASHINGTON, DC
From The Economist print edition

A thug on the run nearly messes up one of the few examples of moral diplomacy

THE grand moral foreign policy of spreading democracy to lands that lack it may have hit a few speed bumps, but the sub-plan to put ex-dictators in the dock is going well. In Iraq, Saddam Hussein is being shushed by a judge he might once have had killed on the spot for such impertinence. And now it looks certain that a man many consider the most blood-soaked in Africa—Charles Taylor of Liberia—will stand trial.

It nearly went horribly wrong. On March 27th, Mr Taylor disappeared from the mansion in Nigeria where he had been under guard since 2003. The exact combination of bribery and/or incompetence that allowed him to slip away is unclear, but he was nabbed trying to cross the border into Cameroon in a jeep stocked with cash.

Mr Taylor was pushed out of office in 2003 by the threat of American force. Nigeria offered him refuge on condition that he came quietly and ceased to meddle in Liberian politics. He continued to meddle. America quietly urged Nigeria's president, Olusegun Obasanjo, to extradite him. After an elected government took charge in Liberia in January, Mr Obasanjo said it could come and get Mr Taylor. That prompted his flight—which was all the more embarrassing because it came two days before Mr Obasanjo was due to visit Washington, DC.

Mr Taylor has now been handed over by the UN to the international war-crimes tribunal in Sierra Leone. His own country has been too wrecked to assemble charges against him, but the Sierra Leone court has. (The court is an ad hoc one of the sort that Mr Bush likes, as opposed to the permanent International Criminal Court he opposes).

Asked on March 29th about the chances of Mr Taylor standing trial, Mr Bush joked that he was “much more confident today than I was yesterday”. In fact, if the blood-stained Liberian had not been recaptured, Mr Bush might well have been forced to cancel his meeting with Mr Obasanjo. An alliance of Christians and blacks is demanding Mr Bush end impunity in Africa.

Now Mr Bush wants to bolster the African Union peacekeeping force in Darfur with UN blue helmets and NATO logistics. He won't say which Sudanese warlords ought to be in the dock, but they will have watched this week's events with dismay.

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America and Japan

Blossoms and booze

Mar 30th 2006 | WASHINGTON, DC
From The Economist print edition

What cherry-blossom-watching tells us about two great cultures

Corbis

Glorious even to the sober

THE arrival of spring raises an important question. Is it better to admire the cherry blossoms drunk or sober? In Japan, the consensus is “drunk”. When the *sakura* bloom, Japanese people sit in parks getting raucously sloshed and contemplating the transience of life, as symbolised by those briefly spectacular flowers. Everyone agrees that alcohol heightens the experience.

Not so in Washington, DC. America's capital ought to be a great place for *hanami* (flower-watching) parties. The Tidal Basin below the Mall is surrounded by some 3,000 cherry trees—a gift from Japan in 1912. The annual National Cherry Blossom Festival, which began on March 25th, involves copious amounts of art, fireworks and light opera. But no drinking. Open a Bud beneath the opening buds and you risk arrest.

How do visiting Japanese feel about this outrage? They may be too polite to say. “Drunken *hanami* parties are fun, of course. But they can be vulgar too, with all the karaoke machines,” says Naoki Ito, a tourist. “Actually, I prefer it here,” says Kyoichi Shimazaki, a Tokyoite who works in DC. The cherry blossoms in Japan may be prettier (to a purist), but in America the lack of carousing makes it easier to admire them without interruption, he says. He adds that, given the lack of fences around the Tidal Basin, if people were to get as drunk here as they do in Japan, they would fall in.

Washington's blossoms are better to photograph, offers Mr Ito: “In Tokyo, there are always buildings or telegraph poles in the background.” And it is so crowded that young salarymen have to camp overnight in public parks to reserve prime blossom-viewing spots for their bosses. That would not happen in America, he reckons.

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Lawlessness in Queens

In hot water over hot coffee

Mar 30th 2006 | JAMAICA, QUEENS
From The Economist print edition

A state senator with bite rides into trouble, again

AT FIRST sight Queens looks reassuringly suburban: children play safely, houses have gardens and some even have pools. But there is a less rosy side. The borough is where people still smoke in bars, albeit illegally. John Gotti, the mafia don, lived there, before he was sent to the Big House. Queens welcomed New York's red-light district, when it was kicked out of Times Square. And two police officers were recently arrested for protecting a lucrative brothel from police raids (in return they had received money—but still had to pay for the sex, though at a discount).

Now even the borough's politicians are in trouble with the law. On April 6th, Ada Smith, a state senator from Queens, is due to appear in court to face charges of assaulting an aide in the State Legislative Office Building. It is all said to have happened, according to Albany's *Times Union*, after Ms Smith returned from a Weight Watchers meeting claiming that she had lost 4lb (1.8kg). The aide remarked that she thought the senator would have lost more, given her active lifestyle. At which, Ms Smith allegedly snapped, threw coffee at the aide, pulling out her hair extensions.

Ms Smith, a Democrat who has been in office since 1988, has quite a history of erratic behaviour. Victims of her reported tirades have been hit with spittle as well as coffee. Although she was cleared of any wrongdoing last year by the state Division of Human Rights, her former chief of staff claimed that she made racist remarks, and fired him because he was gay. Another ex-staffer accused her of threatening him with a meat cleaver in 1996. She has also had her fair share of encounters with the police. In 2004 she was fined $200 for failing to obey a direct order from the police after she refused to show her government ID card and drove through a security checkpoint at a parking garage at the Empire State Plaza. After a traffic altercation in Brooklyn in 1998, she bit a NYPD officer's hand and had to be subdued with mace.

State Senate officials are said to be considering an unprecedented censure vote against her. Under state law, a legislator can be expelled if convicted of a felony. The latest charge is a misdemeanour but could land her in jail for up to a year. Ms Smith says it is “baseless”. That may well be so, but there's no denying one simple fact. Tammany Hall bosses abused their power, but you have to go to Queens to find a politician who dares bite a cop.

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Civilian soldiers

The changing of the Guard

Mar 30th 2006 | BAGHDAD
From The Economist print edition

America's part-time soldiers are doing well in Iraq; less so in Washington, DC

AP

Reserved, in the best sense of the word

KEITH HUNTER, of the Georgia Army National Guard, nearly didn't make it to Iraq. Army doctors feared the 58-year-old sergeant was unfit, having suffered a heart attack. They let him be deployed to Baghdad last August on the understanding that he would be doing office-work there. But Sergeant Hunter has spent seven months in command of a Bradley fighting vehicle, detaining suspected insurgents. He is the pride of his men, who call him “the Hobbit”, because he is rather short and covered in snowy-white hair. He recently started smoking again.

Civilian soldiers like Sergeant Hunter have been used more in Iraq than in any conflict since Korea. Around 70% of the 336,000 members of the Guard have been deployed there or in Afghanistan since 2001. Up to half America's troops in Iraq last year were guardsmen or reservists.

In Iraq, the part-time and full-time forces get on well. But in Washington, DC, the traditional rivalry between the two camps is hotter than ever.

The first shots of the latest skirmish were fired—as they so often are—during the drafting of a budget, which was presented to Congress in February. Ordered to make cuts worth $1 billion, army chiefs tried shedding 17,000 guardsmen. They argued that, as the Guard was currently 17,000 soldiers short of its 350,000 complement, this was not, in fact, a reduction at all. Unswayed, the Guard's chiefs and their peacetime commanders, the state governors, united in opposition to the cut. Cowed for once, Donald Rumsfeld, the defence secretary, promised that if they could recruit the additional 17,000 guardsmen by the year's end, additional money would be found for them.

As Congress picks over the budget, the conflict has escalated. Mr Rumsfeld wants to cut seven combat brigades from the army, including six from the Guard—though these would be morphed into combat-support brigades. Yet Guard chiefs and their allies see in this another ploy to cut their numbers at a time when they are already hard-pressed.

The Guard plans to be deployed by the president for up to one year in six, in addition to its services to the state governors. But, at this tempo, America could not have maintained its troop levels in Iraq: most guardsmen have already been deployed there for a year, with an additional six months' training. Many people also claim that the chaos in the wake of Hurricane Katrina was worsened by the fact that half Louisiana's guardsmen were in Iraq.

More happily for the Guard, the budget would provide $21 billion, over six years, to replace equipment worn out in Iraq, or needed for an impending high-tech makeover. This was overdue: the Guard has 34% of its authorised equipment, with only 60% of what it needs to protect the homeland from natural, and other, disasters. Non-deployed Guard units have 5% of their authorised rifles and 14% of chemical decontamination kit.

Major-General Roger Lempke, chief of the Nebraska National Guard, says that his force has “enough to support the homeland, and marginally enough to train”. There is little to spare for fresh deployments to Iraq or Afghanistan, where 80% of Nebraska's 3,400 guardsmen have already been sent. Yet Guard chiefs reckon the budget's offering would cover only half of the equipment they need—even if the regular army does not siphon off some of the cash, as it is wont to do.

This is a conflict as old as the United States—which many Guard units, born of local militias, pre-date. State governors, fearing natural disasters, are jealous of the hold of the federal government on their guardsmen (even though it mostly pays for them). Army chiefs—career soldiers to a man—deflect cuts onto the part-timers. Congress, influenced by its many local Guard constituencies, then pegs the cuts back. The current budget would cut $900m from the Guard; in response, its defenders in Congress have already wrung an additional $900m from the Senate Appropriations Committee to buy kit.

Senator Patrick Leahy complains that the Guard is “still being treated like some kind of stepchild, short-changed at

every turn.” He is about to propose legislation that will give the Guard's senior general a fourth star, his own place among the joint chiefs of staff, and more say in the budget. In March, Congress convened an independent commission to consider the Guard's roles and needs.

They might start by considering the Guard's strengths on display in Iraq. Typically older than fire-breathing regular troops, guardsmen are often better at peacekeeping—especially the thousands of civilian policemen among them. They are also good at explaining the war to confused Americans in the communities from which they are drawn. Sergeant Hunter's company, from Gainesville, Georgia, went to war with drums beating and sirens blaring across the town, and it remains a preoccupation for the local newspapers.

But guardsmen in Iraq have also shown they can handle the rough stuff. Sergeant Bobby Mayfield, another Gainesville guardsman, describes an incident: “Just last night, one of our patrols saw a convoy getting shot up both sides of the highway. One Bradley went left, the other went right, fired their asses off till there ain't no more bullets coming out of them [insurgent] bunkers. Then they rolled on home like it weren't nothing, took a shower, went to bed.”

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The rebirth of outrage

Mar 30th 2006
From The Economist print edition

There's an epidemic of outrage

THE most striking thing about Americans to many outsiders is how nice they are. They have none of the aloofness of the British or the *froideur* of the French. On the contrary, they go out of their way to be warm and welcoming. This is the land of the smiley face and the “have a nice day” greeting. Put simply, Americans like to be liked.

Yet turn on cable television and you are confronted with a series of people who are in a perpetual state of outrage. They are incensed (if they're on the left) that Barbara Bush has stipulated that her Hurricane Katrina donation should be used to buy software from a firm owned by one of her sons; furious (if they're on the right) that Hillary Clinton has invoked Jesus's name in decrying Republican immigration policies; and pig-wrestling mad (and here outrage goes bipartisan) that Yale University has admitted a former spokesman for the Taliban.

The current king of outrage is Bill O'Reilly, the host of a Fox television show who only has to look at the camera to convey a sense that some monstrosity has been committed. But there are plenty of others. Sean Hannity (also at Fox) and Joe Scarborough (at MSNBC) are furious about whatever the Democrats have done that day. Over at CNN, Lou Dobbs, under the guise of presenting a news programme, bashes the government for failing to fix America's borders, and big companies for exporting jobs abroad. The oddest of the lot is Don Imus (also at MSNBC) who sits there with a cowboy hat on his head and a scowl on his face, fulminating about whatever irritates him at that moment.

Cast your eyes up to Capitol Hill and the scene is only marginally more restrained. The Democrats have abandoned the idea that politics stops at the water's edge to berate the Bush administration for its “dangerous incompetence” over Iraq. The Republicans can't decide whether they're more outraged at the Democrats' treason or the tide of immigrants. The House Republicans want to build a wall across stretches of the Mexican border. Willie Whitelaw, one of the last great British patrician politicians, once accused Harold Wilson, the Labour leader, of going around the country “stirring up apathy”; these days all too many American politicians, amateur and professional, are going around the country stirring up outrage.

Why is outrage becoming such a defining feature of American life, and particularly political life? It does not apply to the whole country. Four in five Americans tell pollsters that they are either very happy (34%) or pretty happy (50%). Tabloid journalists the world over are in the outrage business. But America's tabloid titans appeal only to narrow slivers of the country (“The O'Reilly Factor” reaches 2.5m people in a country of 300m). Most Americans pride themselves on their tolerance.

Yet things have patently changed since the 1996 election when Bob Dole ruefully asked “where's the outrage?” as he tried to persuade a fat and happy country to ditch Bill Clinton. Today the mood is sourer. A striking 42% of Americans support Russ Feingold's bid to censure Mr Bush for illegally wiretapping suspected terrorists. If the Democrats retake either the Senate or the House this autumn, Mr Bush will probably become the second president

in a decade to be subject to impeachment proceedings.

There are lots of short-term reasons for all this outrage. For instance, the left howls that after 2000 Mr Bush used a narrow victory to push through a highly partisan agenda. But there are also deeper structural reasons why outraged partisans have such a peculiarly strong influence on American politics. For instance, angry people are usually among the most politically active everywhere, but in America a combination of low voter turnout and gerrymandering has allowed radicals to capture both the main parties. Then there are the culture wars: ever since the 1960s American politics has been pulled apart by battles over fundamental values. Other countries have been able to fudge tricky issues, such as abortion, through parliamentary votes; in America, abortion is decided by the Supreme Court—and a debate about the fundamental rights of the individual.

Marginalised and angry

Ironically, both sides of the divide feel marginalised. Leftists feel excluded because the Republicans control every branch of government. Rightists feel left out because the left dominates so much of the cultural world—especially the movie business and the universities (only about 15% of academics admit to being conservative). The natural response to being marginalised is to rage at the fiends doing the marginalising—whether they be the “corrupt cronies” of the Bush political machine or the “dangerous leftists” at Warner Brothers and Harvard.

Worse, many partisans don't accept the legitimacy of their opponents. Plenty of conservatives don't just dislike liberals; they don't regard them as real Americans. (“I never use the words Democrats and Republicans,” James Watt, Ronald Reagan's secretary of the interior, once said. “It's liberals and Americans.”) Many liberals don't just dislike conservatives; they regard them as sexists, bigots and cheats (that 2000 election), not to mention liars and torturers.

These mutual suspicions have deep historical roots. In his book, “Albion's Seed” (1989), David Hackett Fischer argued that the earliest settlers were heavily influenced by the regional cultures of different parts of Britain. The Puritans of Boston had a very different world view from the Cavaliers of the South, and both had different outlooks from the Scots-Irish. These different values ensured that Americans were perpetually engaged in arguments over everything from slavery to religion to, above all, the nature of the United States. This means that America is not just the land of that smiling “waitperson” who just told you to have a nice day. It is also the land of such maestros of outrage as Messrs O'Reilly and Imus.

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Venezuela

The sickly stench of corruption

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A campaign against sleaze raises more questions than answers

Get article background

AS A supporter of Venezuela's president, Hugo Chávez, in the country's National Assembly, Luis Velásquez Alvaray was the author of a law to pad the supreme court with a built-in government majority—and give himself a seat on it. He is now embroiled in an epic exchange of corruption claims that go to the heart of the Chávez administration. Accused of taking kickbacks of $4m for a new judiciary building, he has retorted that drug traffickers are running military intelligence, that the brother of Jesse Chacón, the interior minister, is illegally lobbying for a bank, and that the minister is a pawn of organised crime. Such is the rot that the “Palace of Justice should be blown up”, he says.

Both Mr Velásquez and Mr Chacón deny wrongdoing and claim to have tapes incriminating the other. Mr Chacón still has the president's backing. But the allegations come as no surprise to Venezuelans on either side of their country's bitter political divide.

Mr Chávez claims moral superiority for his “socialist revolution” over “savage neo-liberal” capitalism. He was first elected in 1998 on an anti-corruption platform. In power, he has revealed a taste for designer suits and Cartier watches. He has placed several members of his family in government jobs. Such foibles apart, there is no evidence that he is personally corrupt. But he has repeatedly said that corruption and bureaucracy are his revolution's greatest foes. Eustoquio Contreras, a *chavista* on the parliamentary audit committee, says bluntly that if the government does not put a stop to corruption, “corruption will put a stop to the government.”

Venezuela has long been notorious for corruption. But in the past, at least the opposition held the job of auditor-general and often that of attorney-general, while the judiciary was bipartisan. Mr Chávez has grasped all the powers of state into his own hands, and eliminated all independent oversight of his government. The opposition argues that the inevitable result of this is graft on an increased scale.

Last year, Transparency International, a Berlin-based group, placed Venezuela a lowly 130th out of 159 countries in its annual survey of perceptions of corruption. It was one of a dozen countries where more than half of respondents said this had “greatly” increased. The government's response was tetchy. José Vicente Rangel, the vice-president and once an anti-corruption campaigner, claimed that the group charges countries a “tariff” for their position on the corruption table.

Under Mr Chávez, no prominent official has been jailed for embezzlement. That may now change. A small but emblematic case involves the grandly titled Ezequiel Zamora Agroindustrial Sugar Complex in Sabaneta, Mr Chávez's sleepy hometown in the state of Barinas, where his father is governor. Officially touted as “the most modern sugar mill in South America”, it is now a monument to a different kind of sweetener: the $1.5m in bribes,

kickbacks and commissions that have delayed its opening were exposed in parliamentary hearings in February (after a newspaper broke the story).

Mr Chávez, a former army officer, presides over a regime which is as much military as civilian. An engineering regiment was told to build the sugar complex. It contracted out some of the work and charged a 10% commission on all contracts, many of which went to companies belonging to friends and relatives of the regiment's officers. Many of these companies did no work at all. The regiment's commander paid for a $25,000 pick-up truck for his brother with a cheque from the mill.

The project's director, Antonio Albarrán, told parliament that although he had known about the kickbacks since early 2004, he kept quiet because “we were in the middle of campaigning” (to defeat a recall referendum against the president). By the end of 2004, Mr Chávez had been told, but chose to maintain the policy of secrecy, opting to deal with it as a matter of military discipline. He also promoted Mr Albarrán, making him agriculture minister in January 2005. Several suspects are under arrest, but Mr Albarrán, though no longer a minister, is not.

In half a dozen previous cases under the Chávez government, military officers have been accused by parliamentary committees, the auditor-general and others of embezzlement or misuse of public funds totalling hundreds of millions of dollars. None has yet been charged. Several still hold government jobs.

Civilians have not been immune to temptation. Mr Contreras cites half a dozen cases where the government's agricultural-development fund gave cheap credits to fake co-operatives, or which covered much more farm land than the village in question possessed.

Does the sugar-mill case presage a serious crackdown? Opponents note that a presidential election is due in December. At issue will be whether or not a massive increase in public spending, funded by high oil prices, is translating into better public services—or whether, as the opposition claims, much of the money is being skimmed off. A few show trials of scapegoats would be politically useful.

What needs to be established is whether such cases are the exception or the rule, and whether they involve petty pilfering or grand larcency against the state and, as Mr Velásquez claims, massive bribery of its agents. The only way to get an answer would be through the fearless application of the rule of law. There is little sign of that. Dalila Solórzano, a former police officer, was hounded out of the force for pursuing a case against the head of the investigative police. “We've been in this struggle since 2002,” she says, “and no one has done anything. They talk a lot of rubbish because it's an election year, but the political will doesn't exist.”

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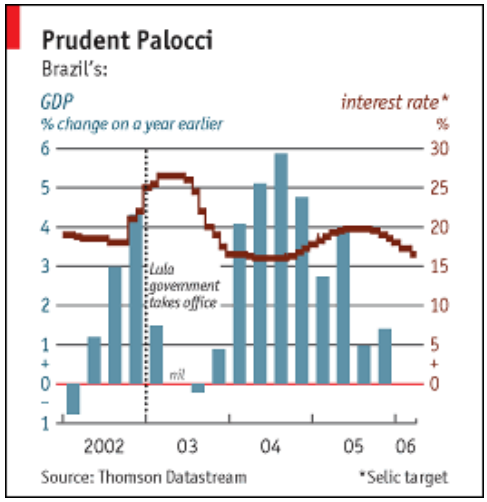
Brazil's new finance minister

After Palocci

Mar 30th 2006 | SÃO PAULO
From The Economist print edition

A new battle to win investors' trust

Get article background



THE policy is set by the president, Luiz Inácio Lula da Silva, but its main executor and most trenchant defender since January 2003 has been Antonio Palocci, the finance minister. Now Mr Palocci is gone. He fell on March 27th because his office was party to the illegal disclosure of payments to a bank account belonging to a witness against him in a corruption case. His successor, Guido Mantega, promises to steer the same economic course. But there are doubts about his commitment to do so.

Mr Palocci backed cautious fiscal and monetary policies, which have maintained financial stability but not yet brought sustained growth (see chart). His departure makes it less likely that Lula will enact ambitious reforms if he wins a second term in an election next October. After the sacking, the real fell by 2.7% against the dollar and the risk premium on Brazil's bonds rose 0.6%. That may be an under-reaction.

Mr Mantega has advised Lula on economics since 1993. His most recent job was heading the BNDES, Brazil's main development bank. He sometimes criticised the rigours of Mr Palocci's policies. When the economy slowed last year, he blamed the central bank for an “excess of [anti-inflationary] zeal”. When Mr Palocci argued for a higher primary surplus to cut the public debt, Mr Mantega objected that public investment would suffer.

Having donned Mr Palocci's hat, he has quickly changed his line. A lower primary surplus “wouldn't help” growth, he said. Interest rates are already falling fast. Even if he wanted to ramp up spending or slash interest rates faster to help Lula's election prospects, he has reasons to think twice. A stronger currency has raised the real value of Brazilians' wages, points out Alexandre Bassoli, an economist at HSBC bank. That is one reason why polls make Lula the favourite to win the election. Mr Palocci had already begun a pre-election spending spree: this year's primary surplus is unlikely to exceed the target of 4¼% of GDP, well below last year's 4.8%. Anything less would shake confidence, the last thing Lula wants before an election.

Less certain is whether Mr Mantega will go “the extra mile” as Mr Palocci has done, says Roger Scher of Fitch, a credit-rating agency. Mr Palocci had a long-term plan to shift the economy into higher gear, which involved cuts in taxes and public spending (non-financial spending would fall by 0.2% of GDP per year). Mr Mantega is more inclined to see the state as a promoter of growth than as an obstacle. Thrift is necessary, he said, but “there is no long-term fiscal plan.” Mr Palocci's removal has been followed by an exodus of like-minded aides. (Contrary to rumour, it now appears that the central-bank president, Henrique Meirelles, will stay.) No one knows who will run economic policy in Lula's second term—if there is one.

With Mr Palocci out, the opposition will now go after Lula himself. On March 29th, a congressional investigative committee published a report absolving Lula of direct responsibility for the *mensalão*—a bribery scam that has implicated a score of congressmen, the PT's top officials and the president's former chief of staff. But the committee chairman said he would call for the indictment of more than a hundred people, including former senior officials. The opposition will do its utmost to ensure that Lula suffers for the scandal in the election campaign.

Brazil's economy is far more solid than it once was. But the strength of its currency and of its bonds owed much to the confidence that investors had learned to place in Mr Palocci. Mr Mantega will now have to earn that for himself.

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Redeveloping Toronto

Covering the whole waterfront

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At last, three governments wield the sledgehammer in unison

DRIVE into the centre of Toronto from the airport, and the sight that greets you is a mess. What ought to be an attractive asset for Canada's largest city, its 29-mile (46km) waterfront along Lake Ontario, is blocked off by a tangle of 19th-century railway lines, an ugly elevated motorway dating from the 1950s, and a line of tower blocks. Arguments have raged for decades over how to redevelop the lakefront. The one insurmountable obstacle has been the rivalry between city, provincial and federal governments.

Toronto has seen pockets of successful redevelopment, such as the Distillery district, with trendy shops, art galleries and cobbled lanes, or a former cold store at Queen's Quay Terminal, which houses offices, flats, and restaurants. But they fall far short of the wholesale revamping of harbour areas in cities as varied as Barcelona, Vancouver, London and Chicago.

So it looked like progress when on March 27th representatives from all three governments donned hard hats and picked up sledgehammers to launch the West Don Lands project, the first step in a plan to reclaim the 800-hectare (2,000 acres) waterfront for the city over the next 30 years. “One big happy family,” quipped John Baird, the treasury minister in the Conservative federal government, as he put his arm around David Caplan, the infrastructure minister in Ontario's Liberal provincial government, while the mayor, David Miller, a New Democrat, looked on.

More than bonhomie may be needed. For almost a century, commissions, governments and civic groups have expounded their vision for the waterfront. Each plan foundered on the twin shoals of physical obstacles and the dispersion of political authority.

The physical obstacles, except the tower blocks, can now be tackled. Much of the railway traffic has been re-routed north of the city. A team of engineers at the University of Toronto has worked out a way to bury the motorway, as Boston did with its cross-harbour expressway. What has been lacking is money and political will.

A bid for the 2008 Olympic games briefly injected urgency. The three tiers of government, which each control key chunks of harbour land, united behind a redevelopment scheme and pledged C$500m (then $330m) apiece. A new body, the Toronto Waterfront Revitalisation Corporation, was created to oversee the work. But the games went to Beijing.

Mr Miller was elected in 2003 in part on a promise to tackle the waterfront. Infighting continued: last year, the corporation and a municipal agency each hired a different architect to design a development on the same patch of land. The city has sparred with the federal government over an airport on an island in the harbour. The mayor wants to close it. A federal agency signed a new contract with an airline.

If peace has finally broken out it may be because of public pressure. That has been stimulated partly by the recent completion of several buildings by well-known international architects, such as an art-gallery addition by Frank Gehry.

The key step is that the city and province have signed agreements giving overall control to the Revitalisation Corporation. That is similar to the model London used to regenerate its docklands in the 1980s. The federal government, and its airport, are still a problem. Last month Mr Miller asked the federal transport minister to transfer the airport's land to the city. All that Leslie Woo, who advises the mayor on the waterfront, would say is that the minister “didn't dismiss the possibility”.

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Coffee in Central America

Fair enough

Mar 30th 2006 | MEXICO CITY AND SAN JOSÉ
From The Economist print edition

Taking the quality route to survival

Reuters

Heading for your skinny frappuccino

Get article background

MAKING good coffee is not a simple business. Coffee bushes must be grown in shade—neither too much, nor too little. A hillside is best—but it mustn't be too steep. After three years, the bushes will start to produce bright-red coffee “cherries”, which are picked, processed to remove the pulp, and spread out to dry for days, ideally on concrete. They are milled again to separate the bean, which needs to rest, preferably for a few months. Only then can it be roasted, ground and brewed into the stuff that dreams are quelled with.

In Mexico and parts of Central America, as in Colombia and Peru further south but not in Brazil, most coffee farmers are smallholders. They found it especially hard to deal with the recent slump in the coffee price. The price has since recovered: the benchmark price applied to mild coffee now ranges from $1.11 to $1.14 per pound. That is roughly double its rock-bottom level of August 2002.

But the volatility of their income makes it hard for farmers to invest to sustain their crop, says Fernando Celis of the Mexican National Organisation of Coffee Growers. The slump forced many small farmers to switch to other crops, or migrate to cities. Mexico's exports of coffee are less than half of what they were six years ago.

For farmers, one way out of this dilemma is to decouple the price they are paid from the international commodities markets. This is the aim of Fairtrade, a London-based organisation which certifies products as “responsibly” sourced. Fairtrade determines at what price farmers make what it considers a reasonable profit. Its current calculation is that the appropriate figure is 10% above the market price.

Worldwide, sales of Fairtrade-certified coffee have increased from $22.5m per year to $87m per year since 1998. This is still only a tiny fraction of the overall world coffee trade, worth $10 billion annually. But there are plenty of other niche markets for high-quality coffee. Some small producers can charge more by marketing their coffee as organic—a switch which takes five years or so—or “bird-friendly” because, unlike large, mechanised plantations, they have retained shade trees.

Starbucks, the Seattle-based coffee-bar chain, says it uses a similar formula to that of Fairtrade in buying its coffee. All is bought at a “fair price”, says Peter Torrebiarte, who manages Starbucks' buying operation in Costa Rica.

Some niches can be large. Only 6% of world output is of top quality, but in Costa Rica and Guatemala the figure rises to 60%, says Mr Torrebiarte. Starbucks bought 37% of Costa Rica's entire coffee crop in the 2004-05 season, according to Adolfo Lizano of the country's coffee institute.

Mexico lags behind its neighbours in extracting higher prices. But 95% of the coffee in Mexico is arabica—the type

of bean demanded by connoisseurs—rather than lower-grade robusta. Almost all of it is grown at altitude, which also improves quality. So Mexico, too, has the potential to compete on quality rather than price. Only by following the path forged by Costa Rica and Guatemala, says Mr Celis, can Mexico's coffee growers survive in the world market. For their part, discerning coffee drinkers can satisfy their palate and their conscience at the same time.

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China

The white peril

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From The Economist print edition

China is starting to worry about the size and impact of the foreign investment it has so assiduously courted

“HEAVEN help China,” said a front-page headline last December in *China Industry News*, a normally staid state-owned daily paper. For four months, the newspaper had been running a series of reports into takeovers of Chinese machine manufacturers by foreign companies. If such buy-outs of key firms were allowed to continue unfettered, the newspaper quoted “experts” as saying, China would lose the high-value-added core of industry built up by the “hard struggle of successive generations” since the communist takeover in 1949.

Seldom has China heard such openly expressed misgivings as it has in recent months over the impact of foreign investment and economic reform. Earlier this month, during the annual session of the National People's Congress, China's parliament, the then head of the government's statistics service said that if “malicious” mergers and acquisitions by foreign companies in China continued unchecked, China's brands and its innovative ability would disappear. The All China Federation of Industry and Commerce, a Communist Party-backed lobby group, appealed to the congress for measures to protect “national economic security” by restricting takeovers in China by foreigners.

Such concerns are common enough in any country, but in China the party has generally stifled grievances about economic policy. In the build-up to the country's accession to the World Trade Organisation in 2001, the state-controlled media dutifully stuck to the line that the benefits of joining would outweigh the disadvantages. The media said little as tens of millions of workers lost their jobs in a huge wave of closures and privatisations of state-owned enterprises beginning in the late 1990s. Only in 2004 did debate about this begin to surface after a Hong Kong academic, Larry Lang, made a speech in China attacking the “harrowing losses” resulting from the sale of state-owned companies to their managers.

The debate over foreigners intensified last year, with some papers publishing blunt criticisms of the sale of stakes in Chinese state-owned banks to foreign banks. The deals, critics said, were priced too low, given the huge amount previously invested by the state in recapitalising them because of bad debts. They also worried that the 25% share allowed to be held by foreign companies in each bank would bring the country's vital financial levers perilously close to foreign control.

Some grumbling is hardly surprising in one of the developing world's most open economies. But is it likely to make much difference to further reforms or the opening of the economy to foreign investment? There have been mixed signals. In response to public criticism of asset stripping during management buy-outs of state-owned enterprises, the government last April introduced new restrictions (though not an outright ban) on such sales.

Also, in recent months Chinese leaders have been emphasising the need for “independent innovation” in

technology, implying less reliance on foreign know-how. A possible side-effect of this was a ministerial statement this month that China will rely on its own technology in the construction of high-speed rail links between Beijing and Shanghai and between Shanghai and Hangzhou. German, Japanese and French firms have been lobbying for years for involvement in these projects.

But the leadership was also at pains during the recent parliamentary meeting to stress that economic reforms remained on track. “Retreat offers no way out,” said the prime minister. Officials continue to show eagerness to court foreign investment, an engine of economic growth especially in big cities, where stability is vital to the party's grip on power.

Chinese enterprises have long complained bitterly about tax privileges enjoyed by foreign investors, who have to pay income tax at only 15% compared with a 33% rate for domestic firms. But the legislature continues to dither over the drafting of a law that would unify these rates. It worries that setting them at a level close to the foreign tax rate might considerably reduce revenues, but that doing so much above 15% might scare away foreign investment. One theory is that a unified rate of around 25% will be set this year, with the increases for foreign companies to be phased in over five years.

Just as critics of economic policy are having a greater say, supporters are no less vocal. A book published last month, “Great Breakthrough”, argues vigorously in favour of greater private-sector involvement in industries hitherto the preserve of the state, such as telecommunications and energy. Private entrepreneurs, it says, have become increasingly concerned by the anti-reform sentiment aired in the past year. Huangfu Ping, a pseudonymous commentator whose articles in 1992 helped launch a wave of market-oriented reforms, returned to the fray in January with an article in a leading business magazine attacking what he called “a new wave of thought” opposing economic reform.

Among the country's top leaders it is likely that the same logic will prevail as did in the early 1990s when reformists in the party faced a far more serious challenge. At that time the late Deng Xiaoping won the debate by arguing that the party's survival depended on economic growth. This, he reasoned, could only be delivered by opening China wider to foreign investment and breaking the state's grip on the economy. The current leadership has been talking about steering the country away from a blind pursuit of growth and paying more attention to the concerns of the marginalised. But it shows no desire to abandon Deng's formula for success.

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Thailand

Taxing times

Mar 30th 2006 | BANGKOK
From The Economist print edition

South-East Asia's new model democracy is being tested

EPA

One more futile push

Get article background

THE outcome of Thailand's snap general election, to be held (barring last-minute upsets) on April 2nd, is both certain and uncertain. It seems beyond doubt that Thai Rak Thai, the party of Thaksin Shinawatra, the prime minister, will win almost all the 500 lower-house seats, since the main opposition parties are boycotting the election, claiming it will be unfair. What may remain uncertain for some time is whether the vote will produce a workable parliament and what happens if it does not. Thailand has been a showcase for multi-party democracy in South-East Asia. But its fledgling institutions are being tested in ways the drafters of its 1997 constitution never envisaged.

In the month since Mr Thaksin called the election, hoping to reduce the pressure on him to resign over corruption allegations, a street protest movement, the People's Alliance for Democracy (PAD), has continued to hold noisy rallies. A large core of tens of thousands of supporters show no signs of giving up. But their numbers have not swelled. The protesters have set various deadlines for Mr Thaksin to quit—but each has passed without consequence.

Though PAD's leaders have called for peaceful change, they may privately hope for a spot of police brutality or nasty clashes between their followers and government supporters, to hasten Mr Thaksin's downfall. However, a big group of Mr Thaksin's fans from rural Thailand, calling itself the “caravan of the poor”, has been involved in little trouble since it rolled into town. So far, the police have marshalled all the protests politely and professionally.

Mr Thaksin says he will resign if his party gets less than half the votes cast. He promises, if victorious, to create a neutral panel to reform the constitution, one of the opposition's main demands, and then call a fresh election. He has also invited opposition groups, including PAD, to join a new government. They scorned the offer, allowing him to depict them as implacable.

Opposition groups accuse the ruling party of all sorts of shenanigans. The electoral commission is investigating these, but has so far refused calls to postpone the election. Petitions to King Bhumibol to replace Mr Thaksin with an interim prime minister have also not prospered. After a privy council meeting, the king's chief adviser, Prem Tinsulanonda, ostentatiously exercised his right to vote early. The signal from on high seems to be to let the vote take place and then take stock.

The boycott leaves Thai Rak Thai unopposed in 270 of the 400 constituencies. Unopposed candidates must win at least a fifth of votes cast, or by-elections must be held until this requirement is met. Parliament must convene with a full contingent of 500 MPs (including 100 party-list seats) within 30 days of an election, though the constitution is unclear what happens if it can't. This is but one of several hurdles that may make it hard for Mr Thaksin to convene parliament and form a government.

The number of votes the prime minister gets may also be crucial. In the last election, in 2005, his party won 19m of the 32m votes cast. If he comes close to that again, Mr Thaksin can fairly say that his mandate has been reaffirmed, and carry on. Given his strong support among poorer Thais, who like his expansion of health care and promotion of rural development, this is quite possible. If not, or if some of the allegations against him start to stick, he may step down “temporarily”, or permanently. The absence of a clear signal from the voters could doom Thailand to months of further political conflict.

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Australia and AIDS

Help thy neighbour

Mar 30th 2006 | SYDNEY
From The Economist print edition

Aid programmes for AIDS

AFRICA'S unhappy distinction of being the world's epicentre of HIV, the infection causing AIDS, is being challenged by Asia, from where 40% of the disease's growth is forecast to come over the next few years. Already in China, contaminated blood transfusions in some villages have claimed the lives of most young adults, leaving only children and their grandparents alive. In Port Moresby, the capital of Papua New Guinea (PNG), about 60% of hospital beds are now occupied by AIDS patients. Faced with predictions that AIDS could cost Asian and Pacific countries tens of billions of dollars a year by 2010, two initiatives involving co-operation between government, businesses and aid workers have been launched in Australia to try to stop its spread.

The first is a partnership between the Australian government and the (Bill) Clinton Foundation, a global body set up four years ago by the former American president to fight AIDS. Australia will provide A$25m ($18m) to work with the foundation in China, Vietnam and PNG, mainly to supply tests and anti-retroviral drugs. These are not necessarily the region's three most afflicted countries: India, where 5m people live with HIV, has the most cases outside South Africa. But they do pose a risk of HIV spreading beyond their borders, especially from PNG, Australia's closest neighbour and its former colony.

Over the past decade, HIV has grown alarmingly in PNG to reach 50,000 estimated cases, about 2% of the adult population. Alexander Downer, Australia's foreign minister, worries about HIV's potential to become a “national catastrophe” there, possibly rising to 500,000 cases by 2025. Unprotected sex has driven most of the spread in PNG. In China (500,000 estimated cases) and Vietnam (260,000 cases), contaminated blood transfusions, prostitution and intravenous drug use are the main avenues.

The government-Clinton coalition will work with a second co-operative effort involving Australian companies that have operations in Asia. This has been formed through the Lowy Institute, a Sydney think-tank, which argues that AIDS, left unchecked, could prove another potential source of regional instability along with terrorism.

Margaret Jackson, chairman of Qantas, Australia's biggest airline, who heads the business coalition, says having 8.3m people infected with HIV in Asia and the Pacific threatens the economic life of Asia, especially that of China, Australia's second-biggest export market. The outlook is grim: the number of sufferers is forecast to more than double to 20m by 2010—unless rich countries, like Australia, start exporting their own successful experience in curbing AIDS.

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India

That old Gandhi magic

Mar 30th 2006 | DELHI
From The Economist print edition

Sonia gambles and wins

Get article background

AFP

The renunciator

SONIA GANDHI, the Italian-born leader of India's Congress party, has come a long way since she tentatively entered politics in the late 1990s and then, after leading a general election victory in May 2004, handed the job of prime minister to Manmohan Singh. Uncertainty and shyness have been replaced by an astute instinct for survival, amply on display during the past two weeks. She has turned a crisis that threatened her, as well as the government, into a triumph.

The crisis developed because Mrs Gandhi held public office as chairman of the National Advisory Council, as well as being a member of parliament. The council was created in 2004 to give her a formal role and cabinet rank, with offices and staff, after she renounced the prime minister's job. Unfortunately, government officials failed to exempt it from a list of “offices of profit”, which are forbidden to members of parliament and state assemblies. The council's job is to monitor implementation of the Congress-led United Progressive Alliance coalition's election programme and to suggest policies to the government. It is controversial because of Mrs Gandhi's role and because some of its economic and social priorities, notably an employment-guarantee scheme, are accused of promoting wasteful spending.

But it only became an issue on March 17th, when Jaya Bachchan, the wife of a film star, was disqualified as a Samajwadi Party MP because she headed a film-development council in her home State of Uttar Pradesh (UP). That stemmed from a legal case started by a disgruntled local politician who had wanted Mrs Bachchan's parliamentary seat and whose action, it is widely believed, was encouraged or tolerated by Congress leaders. In addition to having a family feud with the Bachchans, Mrs Gandhi needs to neutralise the Samajwadi Party if Congress is to have any chance of winning state elections in UP early next year.

Demands then built up for Mrs Gandhi to resign her posts. To pre-empt this, the government abruptly terminated a parliamentary session on March 22nd so it could issue an ordinance amending the office-of-profit rules, a move that could not happen while parliament was sitting. That clumsy tactic led to a bigger uproar and prompted Mrs Gandhi a day later to announce that she had resigned as an MP and from the council, in what was billed as a sacrifice mirroring her earlier renunciation of the prime minister's job. Most parties are now supporting plans to amend the office-of-profit law, which is designed to avoid conflicts of interest, so as to protect 50 or more national and state politicians from possible resignation.

Mrs Gandhi will not be gone for long. Thousands of people lionised her when she visited her UP constituency of Rae Bareli this week to prepare for a by-election that will, inevitably, send her straight back to parliament. The whole episode has helped to raise Congress's profile in the state, and should help to galvanise party loyalists ahead of elections in five other states that start on April 3rd.

It was, in fact, a performance worthy of her mother-in-law, Indira Gandhi, who as prime minister perfected the role of martyr before adoring crowds. Sonia Gandhi told Rae Bareli this week that she was the “enemy number one” of Congress's critics who fired “every stone...every arrow...and every bullet” at her, making her a victim of the kind of treatment they had given to Rajiv Gandhi, her late husband and Indira Gandhi (both were assassinated), and to Jawaharlal Nehru, India's first prime minister. The crowd loved it. That's profit, not sacrifice.

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Japan and its past

Slave wages

Mar 30th 2006 | TOKYO
From The Economist print edition

The long fight for compensation for wartime slave labour

Get article background

LIKE Nazi Germany, wartime Japan made abundant use of forced labour. Across Asia millions were enslaved to boost the imperial war effort. In Japan itself, hundreds of thousands of Koreans, nearly 40,000 Chinese and a smaller number of Allied prisoners were brought by force to work in construction, mining and the like, mostly in the last two years of the war. For these people, conditions were atrocious, and death common—for instance, almost one in five of all Chinese brought to Japan died in 1943-45.

The manner in which Japan today deals with this legacy of forced labour stands in stark contrast to the German approach, where over the past few years facts have been established, guilt admitted and compensation—$5 billion of it—paid to 1.6m victims by the German state and 6,000 offending companies. There is rather more to Japan's failure to settle historical scores with its neighbours than its leading politicians' provocative visits to Tokyo's controversial Yasukuni shrine.

The Chinese labourers brought to Japan were taken from mainland prisons, duped with offers of lucrative jobs in Taiwan, rounded up in northern Chinese hamlets at gunpoint or even caught with nets in country lanes. About 4,000 survive today. Some of these, in a handful of lawsuits working their way through Japanese courts over the past few years, are seeking redress both from the state and the Japanese companies that put them to work. But they are not finding it easy.

On March 29th the Fukuoka District Court on southern Kyushu island dismissed a suit brought three years ago by 45 Chinese enslaved labourers or their families against the state and two giant corporations, Mitsui Mining and Mitsubishi Materials. These are the modern descendants of conglomerates that ran mines on Kyushu with slave labour.

Mitsubishi's brazen defence broke new ground in such cases. It questioned whether Japan had even invaded China, preferring to leave that difficult question to future historians. It denied the company had used forced labour—even though Mitsubishi built and operated a notorious fleet of “hell ships” that brought victims in the cargo hold to Japan. And it asked the court to see through to the plaintiff's political motives: to fall for these would be to produce a “mistaken burden of the soul” for future generations of Japanese.

In curtly dismissing the case, the court said, among other things, that time limits for filing claims had expired. That is a common reason for the dismissal of such cases, but hardly a persuasive one. Japan and China did not even re-establish diplomatic relations until 1972; and suppressed reports from Japan's foreign ministry about the extent of the forced-labour programme have come to light only since the mid-1990s. All this has made meeting the deadline decidedly hard.

The government's usual stance is that all wartime claims and grievances have long been settled—notably by the 1951 San Francisco peace treaty with the United States, and by the agreements in which Japan re-established diplomatic relations with South Korea and China. Successive American administrations and courts have accepted this argument too. In a case brought by an American prisoner-of-war against Mitsui, the American Supreme Court has upheld the finding of a federal-court judge in 2000 who, while accepting that prisoners had not been compensated, found that “the immeasurable bounty of life for themselves and their posterity in a free society and in a more peaceful world services the debt”.

In Japan, says William Underwood of Fukuoka Jo Gakuin University, even plaintiffs' setbacks help to establish historical facts. And he thinks the issue of forced labour is certain to become more prominent. That is because plaintiffs and their lawyers now promise to press their cases in courts in China, where the issue of compensation for forced labour is as hotly followed as it is coldly ignored in Japan. Japanese firms have interests to protect in China. Mitsubishi alone stands to make millions from construction contracts for Beijing's 2008 Olympic games. Which is why the day after the Fukuoka ruling this week, the firm was due to receive the plaintiffs' lawyers in its Shanghai offices.

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About sponsorship

Nuclear power in Japan

Allergic reactions

Mar 30th 2006 | TOKYO
From The Economist print edition

Low public trust in things nuclear

Get article background

JAPAN relies on nuclear power for nearly a third of its electricity, and a lack of local sources of energy, coupled with a national commitment to reduce greenhouse-gas emissions, imply that this figure will have to rise to 40% over the next few years. But deep suspicion of nuclear energy and its regulation is not helping. Local opposition has, since 2003, forced three utilities to shelve plans for new nuclear plants. Now, on March 24th, a court ordered the newest and biggest of the country's 55 reactors, at the Shika plant in western Japan, to stop operations, barely a week after it had come onstream. The court upheld a case brought by residents who argued that the reactor's design took too little account of the risk of big earthquakes. The power utility plans to appeal.

About a fifth of the world's nuclear reactors sit in what are reckoned areas of “significant” seismic activity; in Japan, make that 100%. To date, the performance of Japan's nuclear plants has been exemplary during earthquakes; they have either sailed through unruffled, or reactors have shut down automatically. Nonetheless, human errors and cover-ups have generated unease. An accident in 1995 has kept one reactor closed to this day. In 1999, at a facility outside Tokyo, workers mixed enriched uranium by hand to save time, and caused a runaway chain reaction, killing two workers and irradiating hundreds of villagers. In 2002, details of falsified inspection and repair reports forced the temporary closure of 17 plants. And in 2004, steam from a broken pipe that had not been inspected for two decades killed five workers in western Japan.

Still, Japan's nuclear programme is not completely off the rails. This week the governor of Aomori prefecture gave his blessing to Japan's first commercial nuclear-fuel reprocessing plant. Given its distance from the country's industrial areas, northern Japan does not lightly turn away business—even of the nuclear sort.

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Israel

Kadima's indecisive victory

Mar 30th 2006 | JERUSALEM
From The Economist print edition

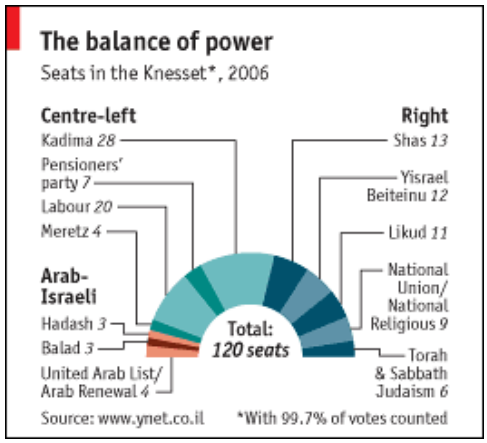
EPA

Israel's election reveals a divided and disillusioned polity, and ambivalence about how to solve the conflict with the Palestinians

Get article background

TO BORROW the gnomic phrasing of America's defence secretary, Donald Rumsfeld: there are expected unexpecteds, and there are unexpected unexpecteds. Israel's election had both. With a record low turnout and many voters undecided until the last minute, pundits expected surprises. One was lukewarm support for the centrist Kadima party. Another was a surge for various far-right parties at the expense of the centre-right Likud, though few thought it would sink as low as a painful fifth place (see chart). But Gil, the pensioners' party, came truly out of nowhere.

Both the Likud's collapse—in 2003 it led with 38 parliamentary seats—and the flowering on the right reflect the economic, religious and political fractures in today's Israel. When Ariel Sharon, one of the Likud's founders, demolished Israel's settlements in Gaza last summer, he broke a taboo on giving up occupied land without a peace deal in return. Likud voters who thought it was the right thing to do have voted for Kadima, the party he subsequently formed. Of those who disagreed, some stayed with Likud. But others abandoned it because they thought it too soft; still others, because its leader, Binyamin Netanyahu, is seen as hard on the poor. The National Union-National Religious Party sucked in the more hawkish, pro-settlement types (the religious and political right). Shas did well with impoverished orthodox Jews (religious right, economic left). Yisrael Beiteinu, originally a party for post-Soviet immigrants, got around a third of its votes from non-immigrants who like its stance: political right, economic left, and a distrust of the influential religious establishment.



Meanwhile, Kadima's 28 seats, less than predicted by polls, shows the disgruntlement of the mainstream voters the leading party thought it had a grip on. Though many clearly back its plan to give up much of the West Bank unilaterally—Labour's 20 seats represented a desire for the same plan with a more leftist social agenda—many also stayed away. That is why the three parties representing Arab-Israelis did relatively well: with Jews abstaining, Arab votes counted for more. Meanwhile, Gil (the pensioners' party) tapped protest voters with a clever campaign trick in the final days: it urged people to vote for it instead of dropping in a blank ballot, the standard form of protest. Straw polls suggest that many of those who gave the pensioners seven seats were their grandchildren.

All this makes for a fragmented legislature, even by Israeli standards. Now the horse-trading begins. The 61 seats needed for a majority will almost certainly include those of Kadima and the centre-left Labour party, which roughly retained its seats. The coalition might also include all the small leftist parties. But either Shas or Yisrael Beiteinu might be flexible enough on the territories to join, and lend right-wing balance.

Once the coalition is ready, which could be by mid-April, Israeli-Palestinian relations can come out of the suspended animation imposed by two parallel election seasons. In their campaigns, Kadima and Labour vied alternately to look tough on the Palestinians' new, hostile Hamas leadership, and to insist that they prefer peace talks to unilateralism. The current line is that Hamas has a year to meet Israel's conditions for holding talks: namely, recognising Israel, renouncing violence, unifying the Palestinian security forces and dismantling other armed factions.

Paradoxically, though Palestinians have voted for extremism and many Israelis for unilateralism, some say the time for talks is propitious. Khalil Shikaki, a respected Palestinian pollster, says that a majority on both sides still wants talks, under the right conditions. But a lot will depend on who will be in Israel's ruling coalition, and whether they choose to encourage any glimmers of hope, or prefer Israel to go it alone.

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Palestine

Camelot, Hamas-style

Mar 30th 2006 | JERUSALEM
From The Economist print edition

The new Hamas cabinet is isolated

Get article background

OMAR ABDEL RAZEQ appears friendly, sincere, eager to please and slightly lost. Little wonder. Two weeks before this interview with *The Economist* he was in an Israeli jail, where he says he lost 40 kilos (88lb) during 92 days of detention (probably for the best, he admits laughingly). Now he is the Palestinian minister of finance.

It must be one of the world's least enviable jobs. Hamas, the militant Islamist movement that won the legislative elections two months ago, is suffering isolation at home as well as abroad. Having failed to persuade other parties to join it in a coalition government for the Palestinian Authority (PA), it formed a cabinet of its own which was finally approved by the Palestinian parliament on March 28th. The new cabinet is trying to project an image of itself as a technocratic, apolitical administrative team. “You have to discriminate between Hamas and this government,” says new deputy prime minister Naser Shaer (PhD, Manchester University), who goes on to point out how many of his colleagues were educated abroad.

But now Hamas is witnessing the surreal spectacle of Palestinian politicians and Israeli officials attacking it in virtually the same words. Its recent statements that it might agree to peace talks and a Palestinian state confined to the pre-1967 borders (ie, the West Bank and Gaza) if Israel first promises to honour those borders (ie, remove all its settlements) have been dismissed by Israel as “double talk”. And members of the ousted Fatah party describe them as “only slogans”. Some factions might be willing to join a coalition, says Qays Abdul Kerim of the Democratic Front for the Liberation of Palestine, a small leftist party, but Hamas must first “clearly say they are ready to negotiate on the basis of the UN resolutions” which recognise Israel. Hamas, having made its overtures, now reckons that “the ball is in the Israeli court,” says Mr Shaer. But there the ball will stay at least while Israel politicians complete their own coalition wrangles (see article).

For now, Hamas must deal with domestic issues: coping with a budget deficit that was out of control even before Hamas won the election and Israel and the West started shutting off the financial taps; improving social services; reforming the bloated PA administration; and imposing law and order on the Palestinian clans, criminal gangs and armed militias. On these, its ministers are full of promise but, as yet, thin on detail. Mr Abdel Razeq (PhD, University of Iowa) says he is confident that Hamas will find other sources of funding. He hopes eventually to improve the PA's financial efficiency by 30% by cutting waste, and to increase revenue collection by 40% by improving public confidence. But he does not yet know how this month's PA salaries will be paid.

The housing and public-works minister, Abdelrahman Zeidan (BSc, Alabama State University), who admits that being offered the job was “a shock” and that he did not want to accept it, talks of using housing projects to give the economy a boost, but does not know who will bankroll them. The ministers say that they will give Western donors whatever guarantees and monitoring mechanisms they need to make sure that their money is spent as intended. But the gates are closing: shortly after the cabinet was sworn in, America banned its officials from all contact with the PA and Canada suspended aid. Meanwhile, Arab leaders' support for Hamas has been lukewarm and potential private investors, say PA officials who have toured the region, see the West Bank and Gaza as distinctly iffy propositions.

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The Security Council and Iran

Diplomacy drags

Mar 30th 2006
From The Economist print edition

Too slow for comfort

Get article background

AFP

The enriching Mahmoud Ahmadinejad

IF THE idea was for the United Nations Security Council to glare down Iran over its troubling nuclear activities, taking a full three weeks to draft a non-binding statement calling on the regime to end activities already deplored repeatedly at the International Atomic Energy Agency (IAEA), the UN's nuclear guardian, is hardly an impressive start. Iran in any case says it will go on enriching uranium (a possible bomb ingredient). So the question for the foreign ministers of America, Britain, France, Germany, Russia and China—the six countries most closely involved in the diplomacy—meeting in Berlin on March 30th was: what should they do next?

The initiative, they contend, is now with Iran. But putting a diplomatic end to Iran's nuclear defiance was never going to be easy. Britain, France and Germany had called off two-and-a-half years of fruitless talks last August, after Iran ended an agreed suspension of some nuclear work. Its decision in January to restart actual enrichment-related activities helped propel its case to the Security Council last month.

At Russia's insistence, the council's first rap on Iran's knuckles talks only of "serious concern" at its continuing activities, backs the IAEA's inspectors in their efforts to figure out what Iran is really up to (exploring ways to keep the lights on, it says; building a bomb is what others suspect) and calls for another report from them in 30 days. And if Iran still refuses to suspend its enrichment work?

The six are divided. Russia, backed by China, refused this week to have Iran's nuclear activities declared a "threat to peace and security", since this could open the door to tougher action in future. Getting from this week's statement by the Security Council's president to binding and enforceable resolutions, passed under Chapter Seven of the UN charter, will be a lot tougher. But without that, suggested a recently leaked British memo, Iran is unlikely to pay much attention. At the very least, the memo argued, as a next step the council ought to make suspension of further nuclear work by Iran mandatory.

Would Russia go along with a strategy that would need the credible threat of sanctions to back it up? Like the others, it wants Iran to suspend enrichment and doubts its peaceful intent. Like them, it has been alarmed by recent threatening statements from Iran's president, Mahmoud Ahmadinejad. In an effort to win more time for talks, it has offered (unsuccessfully so far) to enrich uranium on Iran's behalf. But some of the obvious measures if Iran remains defiant—suspending nuclear and military trade, for example—would damage Russia's commercial interests. With Iraq in mind, both China and Russia balk at more forceful action too.

The British have suggested that, to help win Russian and Chinese agreement for tougher measures, another package of proposals might have to be put to Iran (it turned the Europeans' last lot down flat without even reading them). America, however, though trying to avoid actions that would unite Iranians behind the regime, does not want to be seen to be rewarding its rule-breaking.

Stepping up the pressure on Iran requires the Security Council to stick together. Hence the patient efforts of recent weeks to keep Russia on side. But patience is not inexhaustible. Earlier this month, America's latest National Security Strategy picked out Iran as a—perhaps the—major security challenge; for confrontation to be avoided, it said, diplomacy has to succeed.

Iran is already experimenting with uranium-enriching centrifuges and building its first proper cascade of them as fast as it can at its enrichment plant at Natanz. The more the diplomacy is dragged out, the closer Iran gets to learning all the enrichment skills it would need for bomb-making. That is not an outcome that will keep the big powers working together at the Security Council.

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Iraq

Bad day at the Mustafa mosque

Mar 30th 2006 | BAGHDAD
From The Economist print edition

This time, it's America against the Shias

Get article background

AS OFTEN happens with politically charged violence in Iraq, the events that took place at dusk on March 26th at the Mustafa mosque complex in north Baghdad are disputed. Iraqi politicians accuse the American army of gunning down unarmed worshippers. The Americans say that an Iraqi patrol accompanied by American advisers killed 16 insurgents in a firefight during a search “to capture and detain insurgents responsible for kidnapping and execution activities”. The Americans also say that a stash of weapons and a hostage were discovered in the complex after the shooting, suggesting that the place was being used for purposes other than prayer.

All this might have been a typical evening's bloodshed in Baghdad, where both the American army and Sunni insurgents routinely accuse each other of violating the sanctity of holy buildings. The difference this time is that the mosque was Shia, and some of the dead belonged to the Mahdi Army loyal to Muqtada al-Sadr, a volatile cleric with a large Shia following. The Mustafa mosque incident was one of the deadliest involving Shias and the American army since Mr Sadr's militiamen rose against the occupation in the autumn of 2004.

Both the Sadrists and officials from mainstream Shia parties—Dawa and the Supreme Council for Islamic Revolution in Iraq—denounced the events at the mosque as “terrorism” against “innocents”. This fiery language may be connected to a Shia tussle with the American ambassador to Iraq, Zalmay Khalilzad. He has been trying to pressure the Shia-led ruling coalition, the United Iraqi Alliance (UIA), to give up their control of the main security ministries and rein in Shia militias, to reassure frightened Sunnis. He has also tried to persuade the UIA to drop Ibrahim al-Jaafari as its candidate for prime minister and choose a man more acceptable to Sunnis, Kurds and secularists. Mr Khalilzad has been conveying that message to the Shia with the “personal” support of President Bush himself.

The mosque killings took place against the backdrop of a wave of sectarian killings that have left hundreds dead since the demolition of a Shia shrine at Samarra on February 22nd. Many Shias argue that their militias, including the Mahdi Army, are in fact waging a campaign of rightful “purification” against the Sunni extremists believed to be attacking their mosques and other targets. They claim that Mr Khalilzad is seeking to deny them their right to self-defence, and accuse him of pro-Sunni bias. Some talk of a “second betrayal” of the Shias, referring to America's failure to support those who rebelled against Saddam Hussein after the 1991 Gulf war.

The mosque killings also interrupted a series of promising meetings between Iraqi leaders on the creation of a national-unity government. Kurds, Sunnis and secularists still oppose Mr Jaafari remaining prime minister, but they have agreed to put personalities aside for the time being and focus on how a new government might work. Leaders agree that it should contain a “national security” council to give all groups the chance to review major policy decisions. The Shias' acquiescence suggests that they may be starting to accept the necessity of giving the Sunnis a real share in decision-making in order to quell the insurgency. But the path ahead remains bloody.

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South Africa

The road gets bumpier

Mar 30th 2006 | JOHANNESBURG
From The Economist print edition

The government and unions clash over the reform of the transport sector

Get article background

FOR the past two months, South African trade unions have been flexing their muscles over the restructuring of Transnet, the transport parastatal. Local strikes have hit ports and trains, and there was a moderately successful national strike on March 13th. More may come if Transnet's management and the trade unions, who went back to the negotiating table last week, do not reach an agreement. But there is more to the dispute than just labour issues.

Transnet is a diversified behemoth that employs 76,000 people and sits on around 70 billion rand ($11.2 billion) in assets. But it is also notoriously inefficient, which contributes to making logistics expensive in South Africa—consuming almost 15% of GDP. Part of the government's plan to accelerate economic growth rests on reducing the cost of doing business—and therefore cheaper transport.

In 2004, Alec Erwin, the minister of public enterprises, announced that Transnet would focus on freight rail, ports and pipelines. All its other assets would be transferred to other government departments, or sold. A new chief executive, Maria Ramos, was appointed to do the job, and already she has turned a loss of 6.3 billion rand in 2004 into a profit of 6.8 billion rand last year.

But trade unions are unhappy, saying they have not been consulted enough on the restructuring. They want written guarantees that jobs will not be lost and demand that pensions and working conditions will be maintained. Transnet retorts that unions have been amply consulted, and that the restructuring will not involve job or pension losses.

As negotiations between management and the unions reached a stalemate, Mr Erwin—a former trade unionist—stepped into the ring. His intervention may be essential to solve a dispute that, for some unions such as the South African Transport and Allied Workers Union (SATAWU), is as much about their relations with the ruling African National Congress (ANC) as labour issues. The Congress of South African Trade Unions (COSATU), to which SATAWU is affiliated, is part of the alliance headed by the ANC. But COSATU feels it has increasingly been sidelined by the government on economic policy decisions. Transnet may have become the subject of a political arm wrestle.

Thus far, Mr Erwin appears to be standing firmly behind Ms Ramos. The transfer of Metrorail—Transnet's commuter trains unit—to the ministry of transport, which was scheduled for April 1st, has been delayed, but is unlikely to be reversed. However, as the government presses on with the restructuring, a political gesture to the unions might be necessary. It may come with Autopax, the bus company earmarked for sale, which could instead end up remaining in the public sector, though not with Transnet.

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Correction: Israel

Mar 30th 2006

In our article last week on Israel's new politics we said that Amram Mitzna was a Labour candidate in the 2001 election. It was the 2003 election. Sorry.

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Turkey's wobble

A crescent that could also wane

Mar 30th 2006 | ANKARA
From The Economist print edition

Even admirers of Turkey's mildly Islamist prime minister are beginning to worry about his increasingly reckless political tactics

Reuters

Get article background

“I DON'T see what all the worry is about.” With those breezy words, Recep Tayyip Erdogan, the Turkish prime minister, flew to an Arab League summit in Sudan this week, after failing to defuse a spat about who should be the next central-bank governor—a row, moreover, which has rattled the markets badly.

For all his nonchalance, Mr Erdogan must know there is much to worry about in Turkey these days. Alarm bells are sounding over the economy. Relations with the European Union have soured over Cyprus. With Kurdish separatist violence on the rise, some meddlesome generals are rattling their sabres once again.

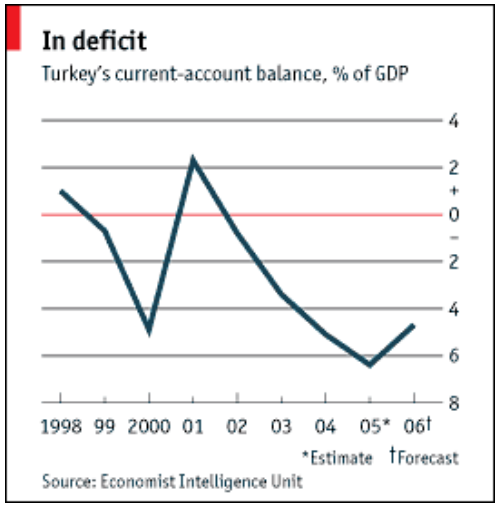
In short, the unprecedented financial and political stability ushered in by Mr Erdogan's three-year-old government is starting to look vulnerable—and many blame his erratic behaviour. Take the central-bank affair. Even Mr Erdogan's allies could not explain his choice of Adnan Buyukdeniz, the head of an interest-free Islamic finance house who has denounced the International Monetary Fund, as central-bank chief. The nomination was rejected by the firmly pro-secular head of state, Ahmet Necdet Sezer, who is thought to have favoured keeping the outgoing governor, Surreya Serdengecti. The presidential veto coincided with a firm scolding for Turkey from the IMF.

The fund's managing director, Rodrigo de Rato, said the country's market credibility had been put at risk by a decision last month to slash the value-added tax paid by textile exporters and to raise public-sector wages. Both measures breached the terms of a $10 billion IMF credit line.

Mr de Rato added that despite robust growth and the taming of inflation, Turkey's economy remained fragile because of high public debt. He might have also mentioned a high current-account deficit (see chart). Record tourism revenues and short-term foreign investment have plugged the gap so far. But with the bird flu outbreak earlier this year deterring visitors, and higher interest rates in America shifting global liquidity away from emerging markets, foreign inflows are set to drop. The IMF, meanwhile, is refusing to disburse the fourth $800m tranche of its standby facility until a social-security reform is finally adopted.

Apparently unfazed, Turkey's controversial finance minister, Kemal Unakitan, said on March 28th that further tax breaks for different sectors were being considered. His comments pushed the Istanbul Stock Exchange's main index down; he then said only tourism would get

rebates.



On the EU front too, the government seems to have lost much of the reforming zeal that helped it, last October, to win the prize of membership talks. This week the EU's enlargement commissioner, Olli Rehn, cautioned that relations with Turkey could be heading for a “train crash” over Cyprus by the end of the year.

Turkey is obliged to open its ports and airports to Cypriot-registered ships and aircraft under an agreement extending its customs union to the ten governments, including the Greek-Cypriot one, which joined the union in 2004. But Mr Erdogan has ruled out taking this step until the EU eases its trade embargo on the Turkish-occupied north of the island.

Many Turks share his view that the EU is hiding behind the Cyprus issue to sabotage their country's membership. Disillusionment with the EU is reflected in polls that show support for membership among Turks slipping from a high of 74% to 58% last month.

Instead of working to salvage his country's ties with the EU, Mr Erdogan has recently paid more attention to cultivating Arab and African leaders. Among them was Khaled Mashal, a senior figure in the Hamas movement who would hardly be welcome—in view of the Palestinian Islamists' refusal to renounce violence—in any other NATO capital.

Mr Mashal was received by the foreign minister, Abdullah Gul—and had it not been for stiff American warnings, the visitor would have met Mr Erdogan. Israel said the damage inflicted by Turkey's embrace of Hamas would be “hard to repair”. But ignoring America's objections this time, Turkey issued an invitation to another Islamist firebrand, the Iraqi Shia cleric, Muqtada Al-Sadr.

Such moves have given rhetorical fuel, at least, to Mr Erdogan's pro-secular enemies who say he is bent on making Turkey an Islamic state. Nominating an Islamist central banker was “only one of the indications”, the secular-minded daily *Cumhuriyet* said in a front-page editorial.

The risks of chasing votes

A more likely explanation for the prime minister's new carelessness is the desire to haul in votes ahead of parliamentary elections next year. Lowering taxes, raising spending and snubbing Israel and America are sure vote-catchers in a country where unemployment has reached 11.2% and pro-Islamic feelings are on the rise.

But Mr Erdogan would be well-advised to weigh the risks carefully. Much of the undeniable success of his government has been rooted in its strict adherence to the IMF programme and its embrace of Turkey's EU goals. The turmoil that would follow any break with the IMF or the EU could allow the Turkish army to recover lost political ground. General Yasar Buyukanit, the hawkish land-forces commander, who is set to take over as army chief, has already traded blows with the government over a nasty affair in Turkey's wildish east: a prosecutor's indictment of three members of the security forces, accused of blowing up a Kurdish nationalist bookshop in the town of Semdinli.

The prosecutor called for the general to be investigated on charges of setting up an armed gang in the south-east to provoke tension with the Kurds and torpedo Turkey's progress towards the EU. In a statement that read like an indictment of the government, the general staff then accused the prosecutor of harbouring a political agenda, and of targeting the secular foundations of the state. The prosecutor now faces charges of abusing his office.

With that sort of unpleasantness brewing, the government would be ill-advised to alienate the EU, whose blessing is its best insurance against the army.

As many of his qualified western admirers see things, Mr Erdogan still has the potential to bring Turkey closer to real democracy than it has ever been; but he could also go the way of many of his predecessors, as a populist failure. Perhaps the best thing about him—shown by a row in 2004 over moves to criminalise adultery—is that he can change his mind.

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Italian cinema

Lampooning a nation, not a leader

Mar 30th 2006 | ROME
From The Economist print edition

Everyone keeps talking about Berlusconi, including his movie-going foes

AP

A mean imitation

RARELY can a film have been awaited by politicians with greater consternation than “Il caimano” (“The Cayman”), which came out on March 24th—right in the midst of Italy's general election campaign. Almost the only things known about it in advance were: 1) that it was being made by the country's most celebrated director, Nanni Moretti and 2) that its subject matter, directly or indirectly, was the prime minister, Silvio Berlusconi.

Since Mr Moretti is a left-winger, many hoped—and others feared—he was working on something like Michael Moore's “Fahrenheit 9/11”, the heavy-handed denunciation of George Bush which some people credited with easing its intended victim's return to office in 2004. One Italian opposition leader suggested the new film's release be put off till after polling day. Romano Prodi, who hopes to oust Mr Berlusconi in the polls that take place on April 9th and 10th, said he hoped the film would not work to his foe's advantage.

Media expectation, heightened by a publicity black-out, was fevered. *Corriere della Sera*, Italy's biggest-selling daily, cleared three full pages for its coverage of the film. But when it was shown, people were disconcerted—and they disagreed wildly on its merits. Some critics thought it was Mr Moretti's most mature work; others his least successful. Where most people concurred was that good or bad, this film was not the anti-Berlusconi diatribe that had been expected.

“Il caimano” tells of a B-movie producer who is talked into making a film about Italy's prime minister and richest citizen. The film certainly contains plenty of hostility to Mr Berlusconi. One character accuses him of “going into politics so as not to go to jail” and there are several allusions to the most sensitive aspect of the prime minister's early career—the still-mysterious source of his initial capital.

Three different people (including Mr Moretti himself, and the theatre actor-manager Elio De Capetani, pictured) play the part of Mr Berlusconi. As Mr De Capetani observed, it is first and foremost a film about the Italians and their readiness to be duped by a salesman of genius. In fact, it is rather a bitter, gloomy sort of movie in which Mr Moretti has one of his characters dismiss his homeland with a contemptuous diminutive—“*Italietta*”.

“Il caimano” is a reminder that, although they often cross, the paths of art and politics are separate. But it is also evidence of the weirdly hypnotic influence that Mr Berlusconi manages to exert on all his compatriots, particularly the most creative among them. No modern European who was not a dictator has made himself quite such a central feature of his country's life. If he is removed this month, Italians will not know what to discuss.

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German health care

Now for the painful part

Mar 30th 2006 | BERLIN
From The Economist print edition

For Germany's ruling coalition, health issues will kill or cure

Get article background

LAST week's regional elections proved that Germany's Christian and Social Democrats—partners in a left-right coalition—can still do one thing well: hold on to their electoral fiefs and keep fringe parties at bay. In fact, the coalition won an increased majority in the upper house.

But that leaves the cohabiting giants with even less excuse for postponing jobs that will almost certainly prove much harder, such as serious, long-term reform. So, this week, they started negotiating in earnest over an overhaul of the health-care system. Success or failure in this area will help determine whether the coalition headed by Chancellor Angela Merkel proves great as well as grand.

Reforming medical provision is tough in any rich country. But as is often the case, Germany presents particular problems. True to European form, its health-care system is a mostly public affair, with statutory insurers financed by contributions calculated as a percentage of gross salaries (currently 14.6%, shared by workers and employers). However, if your earnings top a certain threshold—now €47,250 ($57,000) a year—you can opt for a private insurance plan. For the policymakers, these private providers, which attract people who are prosperous and relatively good health risks, complicate the picture—and they employ rafts of lobbyists.

To compound the challenge, health care is an issue where ideology tends to prevail over pragmatism. Politicians of various stripes have tried to hone their moral credentials by claiming to have found a panacea for a problem that in reality has no easy remedy: how to stop contributions becoming an ever-increasing burden on labour as health-care costs continue to rise. Ahead of last year's federal elections, Christian Democrats wanted to decouple contributions from salaries by introducing a flat-rate premium. Calling such a poll tax socially unjust, Social Democrats suggested keeping a link to pay, while including other types of income, with a levy on capital gains and interest payments.

And then, of course, there are fundamental problems, to do with money, or the lack of it: Germany is obliged under the European Union's stability pact to bring its overall public deficit below the ceiling of 3% of GDP by 2007. Even without any structural reform, a hole of between €6 billion and €10 billion must be plugged to keep contributions stable next year.

Lowering them by using tax money to pay premiums for children, as the Christian Democrats propose, would cost another €15 billion; and that would probably mean more tax hikes, beyond the rise in VAT, from 16% to 19%, planned for 2007.

The shape of the final compromise, which must be found before the summer break, is anybody's guess. There may be an awkward mix of all current proposals. Under one scenario, contributions—the employer's at least—are frozen at today's level; to cover part of the shortfall, a small flat-rate premium is introduced; private insurers are asked to pitch in to equalise risks; and tax money flows in, financed by a “solidarity contribution” tagged onto income tax. If the coalition partners fail to strike a deal, they will simply have to settle on ways to plug next year's hole, while pushing deeper changes into the future.

Such a minimal solution would reflect badly on the grand coalition's ability to come up with structural reform worthy of the name before the next major regional elections in early 2008. And filling this window of opportunity with politics as usual is also unlikely to help much with the grand coalition's main goal: bringing unemployment down. Support for the left-right alliance, meanwhile, is not as solid as it seemed last week. While Christian and Social Democrats trounced their foes, they forfeited more than 1m votes because of poor turnout. Politicians may soon need a cure for apathy too.

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Belarus after the election

A dark hour with no dawn

Mar 30th 2006
From The Economist print edition

With fewer foreigners looking, in go the skull-crackers

AFP

When the thugs go marching in

Get article background

BEATEN up once already during the election campaign, Alyaksandr Kozulin, one of two opposition candidates in the (rigged) Belarusian presidential poll of March 19th, was attacked by riot police and arrested at a post-election protest rally in Minsk on March 25th. Mr Kozulin was attempting to lead protesters towards a prison in which some of the hundreds of people detained during the previous week were being held.

As happened in another ex-Soviet state—Azerbaijan—last November, the government of Alyaksandr Lukashenka, Belarus's president since 1994, waited until most foreign reporters and observers had left town before punishing those who had objected to the election result.

In the small hours of March 24th, police broke up the small tented camp that had been established by protesters in the main square, afterwards trying ludicrously to smear its former inhabitants by planting syringes and pornography at the scene. Then came the brutal beatings and further mass arrests of the 25th. At least one person was seriously injured; several foreign journalists were among those picked up. “They really enjoyed it,” says an American photographer who was pummelled by Mr Lukashenka's thugs (and has the pictures to prove it).

The United States and the European Union have denounced both the poll and the subsequent repression; there is talk of extending an existing list of Belarusian officials banned from entering the EU, and of freezing Belarusian assets held abroad. (Russia, meanwhile, denounced the Western election monitors who had criticised the vote, and stood by Mr Lukashenka.) But the best hope of changing the regime is for the opposition, which mostly united behind another candidate, Alyaksandr Milinkevic, to stay together, and spread the word that there is a real alternative to Mr Lukashenka. Mr Milinkevic decried the treatment of Mr Kozulin.

If he feels imperilled, Mr Lukashenka may yet resort to more extreme measures still (several opposition activists vanished in 1999-2000), though any such crimes may well rebound against him. The next opposition rally is scheduled for April 26th, the 20th anniversary of the nuclear disaster at Chernobyl, which contaminated much of Belarus. The president, meanwhile, mysteriously postponed his inauguration. Shame at his crimes against his own people is unlikely to be the reason.

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Ukraine's election

A freer choice, despite everything

Mar 30th 2006 | KIEV
From The Economist print edition

Ukraine heads for democracy, whatever the hue of its government

Get article background

APART from the appearance of one Molotov cocktail, the gaggle of crooks among the candidates and some old-fashioned hanky-panky in the odd constituency, the parliamentary elections in Ukraine on March 26th were the freest in the country's short history. Only 16 months after the blatantly rigged presidential poll that incited the “orange revolution”, that is no mean feat. The idea that ex-Soviet Slavs are incapable of democracy has been debunked by Ukraine's voters.

Whether the politicians whom they elected can overcome their own post-Soviet habits is another question. The election results feature the same faces as the presidential campaign, but in a different order. The Party of the Regions, led by Viktor Yanukovich—the disgraced loser of 2004—took 32% of the vote. The Regions' showing has been widely but mistakenly described as a Yanukovich comeback: the big constituency in Russian-speaking southern and eastern Ukraine that backed him in 2004 never went away. Next, with 22%, came the eponymous block of Yulia Tymoshenko, prime minister until her government was sacked amid an orgy of corruption allegations last September.

Trailing both, with around 14%, was Viktor Yushchenko, the president who sacked her, and his “Our Ukraine” party. Mr Yushchenko will have expected Mr Yanukovich to come top; but to be walloped so convincingly by Ms Tymoshenko was a blow. Last year's contretemps worked to her advantage: she raised her telegenic profile in government, then ran on a strident anti-corruption platform. But none of the parties will have a majority in the new parliament—which, under a constitutional reform agreed in the revolutionary crisis of last winter, will pick a newly empowered prime minister, and fill other top posts.

So a coalition it must be. There are two basic possibilities. One is an improbable alliance of the two Viktors, Yanukovich and Yushchenko (an option which Ms Tymoshenko would view as a “tragic mistake”); the other, a reunion of the team that took Mr Yushchenko to the presidency, involving him, Ms Tymoshenko and the Socialists, who also scored more than the 3% needed, under a new proportional system, to get into parliament. Last year's calumnies notwithstanding, that looks the more natural fit, though Ms Tymoshenko's strong election showing may actually have jeopardised it. She now wants her old job back, to the horror of some in Our Ukraine. Mr Yushchenko's flirtation with Mr Yanukovich this week may have been a move to apply some pressure of his own.

At least, a renewed orange alliance looks more natural in terms of what are ostensibly the main issues, such as relations with the West and with Russia. (Russia's intervention in the campaign was less obvious than the humiliating, pro-Yanukovich meddling of 2004, though the hike in gas prices imposed on Ukraine at the start of the year damaged Mr Yushchenko.)

Yet in Ukraine, there are other considerations which sometimes seem more important than policy. Each of the parties has its in-house tycoons, busily struggling to acquire and secure their assets. Some of those close to Mr Yushchenko might be happier to embrace Mr Yanukovich than Ms Tymoshenko. If they get their way, says Hryhoriy Nemyria, her adviser, she may run against Mr Yushchenko in the presidential election due in 2009. That would not be a happy prospect for him, especially after this week. For what it's worth, Ms Tymoshenko describes her meeting with the president this week—their first since her sacking—as “very warm”.

Mr Yushchenko's dilemma, as summarised by a senior Western diplomat, is that Ms Tymoshenko “is untrustworthy, and [Mr] Yanukovich stands for principles that he completely abhors.” A final deal now looks unlikely before next week at the earliest—though there will surely be one eventually, if only because the shady characters said to have paid $5m for a place on the candidates' lists (and the legal immunity that MPs enjoy), will not want to see the new parliament dissolved. The likelier outcome is still the orange reunion. If she does become prime minister, Ms Tymoshenko will certainly need to improve on the erratic economic policy of her last tenure.

But even after it is struck, any deal may fall apart during the wrangling over appointments; in any case, it is hard to envisage any coalition lasting a full parliamentary term. And on one level, that won't matter. Slowly but inexorably, the gains of the orange revolution—a free press and honest voting—are changing Ukraine's politics. Even Mr Yanukovich, crass and thuggish in 2004, is now paying lip service to democratic ideas. The tycoons who stand behind Mr Yanukovich—chief among them Rinat Akhmetov, thought to be Ukraine's richest man—may also be changing: just as some of their Russian counterparts did a few years ago, some are realising they can make more money by going straight. New rules against MPs swapping parties in parliament should help make politics less fractious and venal.

Mr Yushchenko deserved his electoral punishment. He has failed to separate business and politics as he promised. Corruption rages on: as that senior Western diplomat puts it, the gas deal with Russia, involving a shady gas-trading intermediary, “stinks to high heaven.” (Ms Tymoshenko opposes it, though only, it is whispered, because her preferred intermediary lost out; she herself insists that she is opposed in principle to the use of middlemen.) For all that, and as much in spite of its politicians as because of them, last week's vote demonstrated that Mr Yushchenko has, on balance, steered Ukraine in the right direction.

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Charlemagne

A weakening magnet

Mar 30th 2006
From The Economist print edition

In a multipolar neighbourhood, the European Union is losing its will to attract

THE latest news from Ukraine and Belarus is certainly a setback for the European Union. Perhaps the strongish electoral showing by Ukraine's pro-Russian camp is not, in the end, a disaster; and even the despotic, vote-rigging President Alyaksandr Lukashenka of Belarus will not be there for ever. But the situation is serious enough to prompt the EU to look again at its so-called “neighbourhood policy”, and be more honest about the costs of enlargement fatigue.

It is tempting to say the outcome of the votes had nothing to do with the EU. Mr Lukashenka has falsified elections before. It is hardly the EU's fault that he rigged another one. In Ukraine, the pro-Russian party that topped the parliamentary poll is not opposed to the EU; its success had more to do with disenchantment with national leaders, not with the EU itself.

But the union can hardly take credit for its role in the orange revolution (when its representatives helped avert violence) and then act as if nothing had changed now that a pro-EU president has seen his party trounced. Moreover, the eastern border is not the only post-communist place where the EU seems to be losing friends and not influencing people. Commission officials are edgy about the Balkans, which face a critical six months in which the future of Serbia, Montenegro and Kosovo is supposed to be settled. Pro-EU governments in the region are under attack from nationalists for being stooges of a union which may never deliver on its promise of membership in the distant future.

That attitude is common in western Europe. But in the east, it has been more usual to see countries banging on the door to get in. That some seem to be turning away instead is not merely unfamiliar. It is an early warning of the damage that awaits the EU if it turns its back on enlargement.

EU politicians argue that enlargement fatigue is inevitable, given the state of public opinion. They say it may even be salutary: if the EU cannot absorb more members, it is better for Ukraine and Serbia to realise that now, rather than later. And to the extent that there is a cost in their disappointment, it will be tolerable. All these arguments are specious.

It is not true that Europeans oppose further enlargement. The most recent poll showed more people in favour than against, though only by 49% to 39%. Politicians have often seen the rejection of the constitution by French and Dutch voters as, in part, a vote against enlargement. There is no evidence to support this.

When researchers asked the French why they had voted no, a mere 3% mentioned “opposition to further enlargement”. That was less than the 4% who had voted in favour of the treaty because it made taking in new members easier. It is right to say there is no consensus in favour of enlargement in big countries. But the notion that “most” Europeans have turned against it is unproven, to say the least.

Politicians, however, are capable of creating a majority where it does not exist. Edmund Stoiber, the leader of the conservative party in Bavaria, has said there should be no more expansion after the accession of Bulgaria, Romania and Croatia (ie, no Turkey and no one else). The European Parliament recently resolved that further accession be subject to the EU's “absorptive capacity” (whatever that is). European leaders, in other words, are choosing to turn their backs on enlargement.

That would not matter if the EU had a coherent alternative for countries that want to apply but fear rejection. It does not. The “neighbourhood policy” is a mess. It was invented to create work for Eurocrats who had been in charge of the “big bang” expansion and were about to find themselves out of a job in 2000.

It lumps together countries with no prospect of membership, like Morocco and Algeria, with countries that think they are as European as France, like Ukraine. Not surprisingly, it infuriates Ukrainians, who say they are in Europe, not neighbours of Europe. One of the leaders of the pro-Russian party calls the policy “humiliating”. Both Ukraine and the Balkan countries say the EU is putting up obstacles to integration, not tearing them down. People in both places are desperate to get EU visas. People in Balkan states have a tradition of studying in western Europe, while Ukrainians have cousins and family members across the border in Poland. Yet at the moment, the only people who can easily get visas are crooks, and talks to change this are going slowly.

Not so irresistible, after all

Europeans often have an image of the EU as a wonderful, beneficial club that other countries are queuing up to join and for which they will wait patiently, for decades if need be. In reality, the EU's borderlands are a ferment of competing interest groups; they could go backwards as easily as forwards. The Serbian government is already being accused by the Radicals (the largest group in parliament) of “losing” Kosovo and Montenegro. Why should it go along with the EU if it is never to become a member? “If there is no intention to expand EU membership,” asks the spokesman for Ukraine's Party of the Regions, “what can we expect from this relationship?”

Preparing for accession is painful. Every reform creates chances for critics of closer ties with the EU. The European Union has an interest in supporting its friends by offering them tangible benefits from co-operation. It is failing to do this. Because politicians are turning their backs on enlargement and because the neighbourhood policy is weak, the EU is not doing as much as it could, or should.

The EU cannot afford a violent Balkans. It too would suffer if Ukraine came to rely more closely on Russia (as Zbigniew Brzezinski, a former American national security adviser, once said, Ukraine is the difference between Russia as an empire and Russia as a more ordinary country). The EU cannot turn its back on enlargement as it is doing and expect to escape the consequences on its borders, or be taken seriously as a world power.

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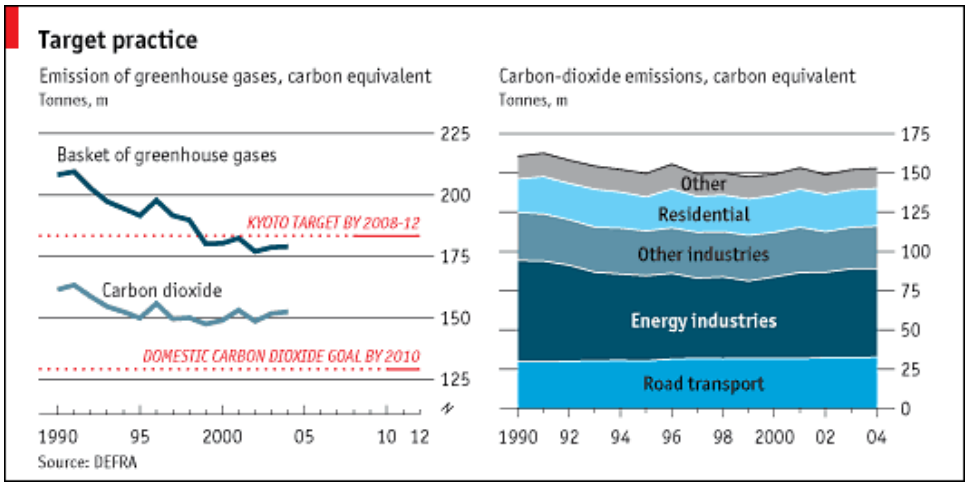
Climate change

Hot under the collar

Mar 30th 2006
From The Economist print edition

Britain will miss its much-trumpeted carbon-emissions target, for all the government's proposed new measures

TONY BLAIR describes climate change as “probably the greatest long-term challenge facing the human race.” He has harangued MPs and foreign leaders alike on the importance of cutting greenhouse-gas emissions. To prove his dedication, the prime minister promised in 1997 that Britain would go beyond its 2008-12 Kyoto target to reduce emissions from their 1990 levels by 12.5%. By 2010, he said, Britain would have cut carbon-dioxide emissions by 20%. But progress towards this goal has been slow and recently it has reversed: carbon-dioxide emissions have risen each year since 2002 (see chart).



So it was that on March 28th a coterie of British ministers admitted what everyone had suspected for some time—that Britain would miss its self-imposed target. That was the main conclusion of the Climate Change review, an official report that was supposed to suggest ways to hit it. Instead, the review forecasts reductions in emissions of just 15-18%, assuming all its recommendations are enacted. Green groups are furious, opposition spokesmen contemptuous. Even business is unimpressed: the Engineering Employers Federation described the report as “feeble.”

All this is embarrassing for a government that has put so much stock in greenery. The 20% pledge has featured in every election manifesto since 1997. In an impressive feat of intellectual contortionism, ministers insist that they have not abandoned the target—it is just that they don't think their new measures will achieve it. Instead of taking a tougher line, they are appealing to a sense of civic duty to make up the difference.

The government is keen to point out that Britain should still meet its Kyoto target. Labour's support for wind farms is one reason. Another is the switch to cleaner gas-fired power as electricity markets were liberalised under its predecessors.

Why is the tougher, self-imposed target proving so elusive? Some of the reasons are beyond official control. Margaret Beckett, the environment secretary, blames faster-than-expected economic growth and high natural gas prices, which are prompting power companies to switch back to dirtier coal. She says that, since the government is exploring uncharted territory, some of its policies are bound to be less effective than it hoped.

But most of the blame belongs at the government's door. One problem is a lack of leadership. The environment department (DEFRA) insists that it is in charge. But the report is nine months late, mainly because of a row between DEFRA and the Department of Trade and Industry (DTI) over carbon allocations for the next round of the European Union's Emissions-Trading Scheme (which caps carbon emissions in certain industries and allows firms to trade pollution permits).

The DTI also has responsibility for energy generation. The Office of the Deputy Prime Minister, meanwhile, writes energy efficiency rules for homes, which produce around 16% of all emissions (see chart). The Department for Transport wants both surface and air transport included in emissions trading, although its plans for airport growth do not take these desires into account. Even the Treasury is getting involved: along with last week's budget it announced a consultation on carbon capture and storage, a subject far outside its traditional remit.

This division of labour is generating plenty of paperwork, including a review of energy policy due this summer (a mere three years after the last one) and another on the likely cost of climate change to the British economy. Bombarded with information and advice from different sources at different moments, the government finds it hard to put forward clear and co-ordinated ideas.

Even when policies are agreed, they can be thwarted by official timidity. Motoring is a good example. After increasing for years, petrol taxes have risen only once since 2000, when protests paralysed the country and gave the Tories a brief lead in the opinion polls. Driving in 2004 was 7% cheaper in real terms than in 1997, and few observers think that the modest tax hike imposed on dirty cars in last week's budget will do much to change matters. According to the Environmental Audit Committee, a parliamentary group, green taxes have fallen as a proportion of total tax revenue—from 9.8% in 1999 to 8.3% in 2004—even as emissions have risen.

The review on climate change suffers from exactly these problems. Beverley Darkin, a researcher at Chatham House, a think-tank, notes that many of the measures are aimed at raising awareness rather than providing incentives to change behaviour. And most are micro: £20m ($35m) to advertise energy efficiency, £50m for small-scale power generation. Some are reheated policies that have already been announced (a pledge that 5% of transport fuel should come from renewable sources by 2010) and plenty are just promises to investigate various schemes. There is little in the way of concrete, radical policy.

In the end, the problem is that climate change is not yet a vote-winner. Compared with answering more immediate worries about jobs, hospitals and schools, efforts to cut carbon emissions promise little electoral gain and plenty of pain.

Domestically, the government should escape relatively unscathed from its failure to hit its target. But its reputation will suffer abroad. The day after the review was published, Tony Blair was in New Zealand, discussing a successor agreement to Kyoto. “If you want to take moral leadership by assigning yourself these tough targets, it is essential that you achieve them, and that other people think that, in achieving them, you have advanced the argument,” says Dieter Helm, an economist at Oxford University. If Mr Blair cannot keep his own house in order, his words will carry less weight with the rest of the world.

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Council workers' strike

Them and us

Mar 30th 2006
From The Economist print edition

The widening gap between public and private pensions is unsustainable

ON MARCH 27th, John Lewis, a retail group, decided to raise the normal retirement age for its pension scheme from 60 to 65. Those over 50 will not be affected, and the change will be phased in for those in their 40s. The decision, agreed by staff, will enable John Lewis to keep its defined-benefit scheme, in which pensions are based on years of service and final salary, open to new employees.

The following day, hundreds of thousands of council workers stopped work to protest against a similar reform to the local-government pension scheme. Schools, libraries and sports centres were closed. Public transport was brought to a standstill in some areas. The 11 unions organising the strike claimed that over a million employees stopped work, the most since the General Strike 80 years ago. The Local Government Association (LGA), representing employers, says that 400,000 were on strike in England.

Whatever the precise number involved, it says much about the fears and concerns of today's workers that they strike over pensions rather than pay, as in 1926. Furthermore, the General Strike was to support miners in their struggle against private pit-owners. This week's strike, by contrast, was designed to bring public-sector employers to heel.

The unions are resisting government plans to raise the effective retirement age from 60 to 65 by scrapping the “rule of 85”. The normal pension age for council workers is already 65, not 60 as in most other public services. However, they can retire as early as 60 on financially favourable terms if their age and years of service add up to 85 or more. Thus, workers with 25 or more years of service can retire at 60 rather than 65 without penalty.

The government and the LGA say that the reform—which would not affect workers who are 60 before April 2013—is essential because rising longevity among pensioners has made present arrangements unaffordable. Unlike the defined-benefit schemes of other public employees such as civil servants, which are financed out of the government's current revenues, the local-government scheme is a funded pension plan. Like many company pension funds, however, it is running a big deficit. At the last actuarial valuation in 2004, the shortfall was £27 billion ($47 billion). Local-government employers have on average been contributing 13.5% of salary, compared with employees' 6%. Yet even if the “rule of 85” goes, employers' contributions need to rise to 17.5-18% to plug the deficit.

The employers have a good case, but it has been weakened by ministers' abject surrender to union pressure in the rest of the public sector. In October, the government retreated from its plan to raise the retirement age from 60 to 65 across the public services. For over 2.5m employees in the National Health Service, schools and civil service, ministers conceded that the change would apply only to new entrants later this year. Under the jettisoned plan, existing workers were also to be affected from 2013.

The unions argue that it is unfair to treat one group of public-sector workers differently from another. But the truly glaring disparity in pension provision is not within government but between the public and the private sectors.

That disparity is already large. The public sector's share of pension wealth—in both occupational and personal pensions—was double its share of employment and of earnings in 2002. What's more, defined-benefit plans remain open in the public sector whereas most have been closed to new employees in the private sector. Contribution rates into defined-benefit schemes are generally double those into the retirement-saving plans offered in their place. As a result, the pension gap between the public and private sectors will widen further in the years ahead.

The unions are threatening more strikes in coming weeks. That will make an awkward backdrop for Labour as local elections approach in May. The government is caught in a mess of its own making. It is paying a high price for failing to stand firm on its original plan to raise the retirement age across the public sector.

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Marriage

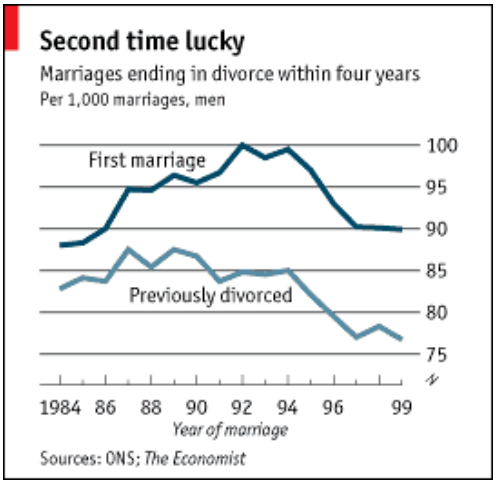
In health

Mar 30th 2006
From The Economist print edition

Why marriages are lasting longer

TO HEAR churchmen and social conservatives tell it, marriage is in a parlous state. It is assailed by a creeping culture of sexual libertinism and by readily-available divorce. Cohabitation, or "living in sin" as it was known in a more morally rigorous era, is now the rule. Social breakdown is the result, according to Rowan Williams, the Archbishop of Canterbury, who told leading politicians last year that saving marriage is a "life and death" matter. Emergency relief, possibly in the form of tax breaks, is said to be required to save this crumbling institution.

Despite the hand-wringing, though, marriage is showing signs of recovery. Couples who tied the knot recently seem to have more staying power than their predecessors. The proportion of first-time grooms whose marriages endure less than five years (a low threshold, but one that provides a clue as to the health of recent marriages) has fallen by 10% from its peak and stands at a 12-year low. Men who remarry after a divorce are 12% less likely to cut the knot than they were during the late 1980s (see chart).



Economic stability is one likely reason. Recessions strain marriages: the worst year for a bachelor to marry was 1992, which was also the last time quarterly GDP growth was in the red. Booms, especially property booms, hold marriages together by raising the cost of living under two roofs. Looking at the 210% rise in property prices over the past decade, some couples will decide that they had better stay together for the sake of the house.

But perhaps the biggest cause of marital stability has to do with the very thing that moralists fulminate against. Cohabitation is, indeed, ever more common. One in ten Britons (and a fifth of all people aged 25 to 34) now lives with a partner outside wedlock. These days, even pregnancy persuades few couples to leave their wicked ways. "We saw the separation of sex and marriage in the 1960s, and the separation of children and marriage in the 1980s," says Jane Lewis, who follows the subject at the London School of Economics.

The fact that cohabitation is so acceptable means that those who do marry are a more select group. They are older: the median age of first marriage for men rose from 26½ to 30½ between 1991 and 2004, and from 39 to 43½ for previously divorced men. They may also be more religious. And, of course, they will probably know their partners better. That may help to explain why the number of bachelors who divorce within two years of marrying (which suggests poor judgment) has almost halved since the mid-1980s.

Anne Barlow, an academic at the University of Essex who has interviewed many cohabiting couples, says that few of them reject marriage on principle. They want to test the relationship first, or would simply rather spend money on a new kitchen than on a wedding. For them, living in sin is not so much a slight to married life as an important step in that direction. How very conservative.

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Army modernisation

An auld lament

Mar 30th 2006 | EDINBURGH
From The Economist print edition

The army drops some famous infantry regiments

WITHIN the ancient walls of Edinburgh Castle, to the accompaniment of skirling bagpipes and the grumbling of old warriors assembled, Scotland's six infantry regiments, including the oldest in the British army, faded into history on March 28th. To planners, this was part of a long-overdue rationalisation: five of the regiments will be reborn as battalions in a new, super-sized Royal Regiment of Scotland. But to many former and serving soldiers, not only in Scotland, it was an act of vandalism.

There is much more, in fact, to the reforms. Completing a process begun in the 1960s, the last single-battalion infantry regiments—the “county regiments” on which the infantry was built—are being amalgamated into bigger regiments, or, in a few cases, into battalions within them. The infantry will drop from 31 regiments to 17, losing four battalions.

For every regiment involved, the change is tinged with sadness, as change so often is; but the benefits look compelling. The reforms will allow the army to scrap a system known as “arms-plotting”, under which each regiment had to uproot whenever it changed its role. Bigger and more self-contained, the new regiments will move less often. The army expects to improve efficiency in training and equipping; the cut in infantry jobs, for example, will be matched by 3,000 new support positions, including logisticians and medics. This should make the new regiments more deployable than their predecessors.

The loss of infantrymen is lamentable when the army is so thinly stretched, but the reforms seem sound. Not that many old soldiers, for whom acquiring regimental loyalty was an essential part of their training, would agree.

Among the disgruntled, supporters of the former Scottish regiments have been the most successful lobbyists. They are irate that there are not enough uniforms to go round, and that the order for 5,000 new kilts, thanks to EU procurement rules, may well go to a foreign firm. But their efforts have secured some sops to local pride: one is that each battalion gets to keep its old regimental hackle on its new caps.

With a reputation for ferocity and the romance of their tartan kilt and plaid, Scottish—and especially Highland—soldiers have a proud war record, right up through their service in Iraq. The Royal Highland Fusiliers won more than 200 battle honours, more than any other regiment. The Argyll's foaming-mouthed resistance at Balaclava, in the Crimean war, was immortalised in the phrase “the thin red line”.

For all the attachment to tradition, there is no reason to think that such fighting spirit cannot be reborn in the new regiments. British soldiers generally have not, after all, fought for king, queen, country or regiment, but rather out of fraternal love for the comrades with whom they served.

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ITV bid

Peak-time drama

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From The Economist print edition

Private-equity firms fight the good fight for ITV

SINCE Carlton and Granada merged in February 2004 to form a single ITV, Britain's largest commercial-television firm, the company's shares have fallen by 14%, while the FTSE 100 has risen (see chart). That woeful record has invited the attention of private-equity firms, who reckon the company needs a change of management. Last week ITV said its board had rejected a proposal from three such firms—Apax, Blackstone and Goldman Sachs Capital Partners—which had offered to buy 48% of it for £1.3 billion. This week, as *The Economist* went to press, ITV's bosses were trying to win shareholders' support and the private-equity gang was deciding whether to make a better offer.

ITV has long been the subject of bid speculation: its core business, the terrestrial channel ITV1, is losing market share as people move to multi-channel television. In 2003, Fidelity, the fund-management firm that is currently ITV's biggest shareholder, booted out Michael Green, Carlton's chairman; Charles Allen, its chief executive, surprised many by surviving the purge to take over at ITV. Last year, Apax reportedly came close to bidding for the company with Time Warner, an American media conglomerate.

The most surprising thing about the current proposal is the structure of the bid itself, the first of its kind in Britain. Usually private-equity bidders aim to buy a public firm cheaply, take it off the stock exchange, load it with debt, fix it and float it again at a huge profit. These bidders have something else in mind. They want to buy just under half of ITV, increase its debt and pay 86p a share to shareholders, who would then keep 52% of the publicly-listed business that remained. That, the bidders hope, should please institutional shareholders, who have often watched private-equity firms run rings around them. This way, says a person close to the consortium, private and public investors would all benefit.

Will the bid succeed? Fidelity has indicated its interest in the private-equity firms' offer. Some shareholders would not want to own highly-leveraged shares, so the group is trying to find a way to offer a cash exit to everybody who wants one without wrecking the deal. Institutions may be sceptical about the bidders' willingness to share the spoils.

Many of ITV's shareholders may also hesitate to sell because they reckon Mr Allen is now doing the right things. He plans to use ITV1 to expand into new businesses, and the strategy finally seems to be working. His acquisition last December of Friends Reunited, a group of websites, was admired by ITV's rivals, and advertising revenue from ITV's digital channels is starting to offset a portion of ITV1's falling sales. Investors are particularly impressed by a profitable new business on ITV1 called ITV Play, which offers prizes to winners of the phone-in quizzes and competitions that it shows through the wee small hours. In April, ITV Play will be launched as a digital terrestrial channel on Freeview.

Mr Allen also compares favourably in some ways with Greg Dyke, the private-equity firms' candidate to replace him as chief executive. Mr Dyke is not known for his ability to contain costs; Mr Allen is. Mr Dyke has bad relations with the government stemming from his time as director-general of the BBC, when he defended a piece of faulty reporting on the Iraq war. Because ITV's profits rely to a large extent these days on achieving regulatory concessions, that matters.

Yet Mr Allen has to take some blame for ITV1's poor viewing figures. Their decline is due not only to structural changes in the market but also to bad management and lack of creativity. ITV1 leans too heavily on tried and tested programme formulae. “They are fairly reliant on tentpole shows like ‘Coronation Street’ and don't experiment much,” says Patrick Wellington, of Morgan Stanley, an investment bank. Mr Dyke, seen as a talented programmer, possesses a strong advantage: “Greg could bring an undefinable sparkle to the peak-time schedule,” says a broadcast executive.

ITV is one of many traditional media companies whose core businesses are threatened by changing consumer habits and new technologies. Until recently, Time Warner, the biggest, has been under attack from Carl Icahn, a corporate raider, who eventually gave up. ITV's shareholders must now decide whether they want more of the same or radical change. Though they naturally distrust their private-equity wooers, ITV's share price is surely in need of a serious jolt.

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Further education

The end of basket-weaving

Mar 30th 2006
From The Economist print edition

Adult schooling is to be the new engine-room of industry

THE revolution in further education proposed by the government this week has an enthusiastic advocate in Paul Head, principal of the College of North East London. His thriving institution in the Tottenham High Road is a haven for 12,000 students in this poor part of the city. Mr Head runs no yoga or fine-art evening classes; instead, he focuses on vocational skills. Students in hard hats and boots learn plumbing and carpentry in one well-equipped area, while others acquire technical skills such as sound engineering nearby. “We're not Fame Academy here,” says Mr Head. “We want them to work in the creative industries, but to have solid skills that will guarantee them job security.”

The white paper released on March 27th embraces this vocational approach. Out go “leisure and pleasure” evening classes in a wide range of subjects including basket-weaving and pottery. The state subsidy for such courses, offered to all adults by 388 colleges, will fall from 73% to 50% by 2010. Expecting demand to drop, many colleges are already reducing the classes they used to offer. Local authorities and charities that also provide adult education, funded by the state but out of a different pot, say they are being cut back too.

Instead, the government will dedicate £25m of new money each year to the narrower but arguably more important task of improving the skills of young people from 19 to 25 years old, essentially those who have already been failed by the education system. They will receive free tuition up to level 3 (the standard expected of an 18-year-old). Other measures aim to draw in high-flying teachers and encourage employers to send more of their workers for state-funded training.

Two recent reviews are behind these plans to make further education the engine-room of the economy. Sir Andrew Foster, once head of the Audit Commission, concluded in November 2005 that the sector needed a “crystal clear” focus on skills. In December, Lord Leitch, chairman of the National Employment Panel, which advises government on welfare reform and business, said that Britain was lagging behind its competitors, with workforce skills ranked 24th out of 29 rich countries.

Those who follow Tony Blair's educational “direction of travel” will spot familiar themes in his latest reforms. Colleges will be encouraged to federate into clusters and call on external backers such as charities and businesses. Failing colleges, and those that inspectors think are “coasting” rather than improving, will be dealt with more toughly. Private providers will compete for the right to run courses.

Paul Head welcomes the white paper but worries that the focus on level 2 and 3 skills will leave out many who need help. Particularly in London, many people read and write at a standard well below what is expected of an 11-year-old. They have to be coaxed on to the bottom rung of the education ladder if they are to clamber on at all. Foundation courses in community centres, best suited to their needs, are threatened by the changes to further education. The Basic Skills Agency, a quango charged with educating poorly-qualified people of all age groups, was not even consulted during the drafting of the white paper, it says.

Labour's vision of further education has travelled a long way since the party came to power. In 1998 David Blunkett, then the education secretary, paid tribute to the self-made Victorians, who educated themselves out of poverty in libraries, clubs and workers' institutes. Further education, he wrote in a green paper on life-long learning, “helps make ours a civilised society, develops the spiritual side of our lives and promotes active citizenship.”

Gone are the days, it seems, when adult education was seen as a public good in itself. Now, as globalisation confronts each country's workers with a wider range of competitors, Labour chants the mantra of employable skills. A return to the technical colleges of the 1960s, from which many further-education colleges emerged, is not as good as fixing mainstream schools, but it is not a bad save.

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London politics

Red-faced Ken

Mar 30th 2006
From The Economist print edition

Why London's Labour mayor is so rude

Get article background

PA

Hiding his blushes?

WHEN Ken Livingstone, London's Labour mayor, first stood for election as a councillor for one of the city's boroughs, Richard Nixon was facing anti-Vietnam marches in America, General Franco was pondering his succession in Spain and Mobutu Sese Seko was deciding whether or not to change the name of the Democratic Republic of the Congo to Zaire. During his 35 years in various elected offices in London, Mr Livingstone has, perhaps unsurprisingly, changed his opinions a few times. The erstwhile anti-establishment, anti-capitalist "Red Ken" is now among the most vociferous defenders of London's police and praises the City of London's capacity to create wealth.

One thing has remained constant, though. Where most politicians are anxious to avoid giving offence to anyone, Mr Livingstone has retained a flair for insulting people. This week he called the American ambassador, Robert Tuttle, a "chiselling little crook" because the embassy (like many others) refuses to pay the congestion charge, an £8 ($14) daily tax on driving in central London. Why does he do it?

"Ken is a brilliant tactical politician," says Tony Travers, an academic at the London School of Economics and astute London watcher. Mr Livingstone certainly chooses his targets carefully.

He has avoided direct rows with the Labour government, but knocking the American ambassador distances him from Labour's America-friendly foreign policy, which in turn reminds London's voters that he opposed the unpopular Iraq war. So, too, his recent argument with David and Simon Reuben, property developers whom Mr Livingstone accuses of holding up preparations for London's Olympic jamboree in 2012, placed him on the side of Londoners against a company that, he claims, stood to make a buck at the expense of London taxpayers. This outspokenness also helps to make him "an easy repository for independent votes," according to Eric Ollerenshaw, a Tory councillor in Hackney.

Mr Livingstone's rule through insult does have its drawbacks. The Reuben brothers, whom he told to go back and "see if they can do better under the ayatollahs", are in fact Iraqi Jews born in India. Coming after a spat with a Jewish reporter for the *Evening Standard* (Mr Livingstone likened him to a concentration-camp guard), the incident has sparked a lively debate among internet bloggers about whether Mr Livingstone is an anti-Semite busily pandering to London's Muslim voters. It is unlikely that he would have used the same language had the Reubens been, say, Jamaican property developers. His insistence that he didn't realise they were Jewish also seems far-fetched. Accusing him of anti-Semitism may stretch the facts but the Labour vote in local elections next month may suffer in Finchley and other parts of London that have an above-average concentration of Jewish voters.

Those elections will be interesting for another reason, too. Every council seat in the city is up for grabs on May 4th, making London the first real test of the Conservative Party's chances of electoral success under David Cameron. The party has been managing expectations, arguing that it did well to get 34% of the vote in 2002 (the last time all London's councillors stood for election at the same time) and that this time it starts from a high base. London Tories also say that the young urban professionals who are thought to like Mr Cameron are hard to canvass (they hide away in blocks of flats where front doors and letter boxes are inaccessible to party activists) and so less likely to turn out.

Even so, Mr Cameron needs to improve his party's performance in London. When the Tories have been in opposition before, a good result in London has been followed by success at Westminster. In 1968, two years before they won a general election, the Conservatives took 60% of the London vote; in 1978 they got 50%. This time, anything above 40% would be a hopeful indicator. And the fiercer political competition in London might even have an unexpected side-effect: forcing Mr Livingstone to be a little nicer.

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Bagehot

Warning signs

Mar 30th 2006
From The Economist print edition

Labour MPs have more to worry about than Tony Blair naming the date of his departure

IT TELLS you something about the febrile state of British politics that a barely audible remark made by Tony Blair in an interview on Australian radio was enough to send Westminster into a paroxysm of conjecture and rumour.

What Mr Blair said, before being interrupted by his interviewer, was that it might after all have been a mistake last year to announce his intention not to fight another election. Paranoid Brownites immediately suspected the prime minister of trying to wriggle out of his promise. Aides in Number 10 rushed in to explain that what the prime minister had meant was that he had been wrong to think his original announcement would dispel speculation about his retirement. They added that he had a timetable for departure in his head. Some MPs demanded that, if so, Mr Blair should reveal it.

Meanwhile, the cash-for-ermine scandal rumbles menacingly on, with Scotland Yard letting it be known that its inquiry could lead to corruption charges. Nobody yet expects Mr Blair to make his final exit from Downing Street in the back of a police car, but equally nobody knows where it will end. If Labour MPs had any sense, however, they would be more concerned about the almost universally bad press for last week's budget and this week's strike by local-government workers.

The negative reaction to Gordon Brown's tenth budget was less due to the lack of eye-catching initiatives than to the sense that he has been doing the job too long, a point which Mr Brown would be the last person to deny. But behind the yawns was something else, a feeling that Mr Brown's huge self-confidence is hardening into complacency and an arrogant reluctance to recognise that the mood of the country may be changing.

The chancellor's greatest conceit—aside from the economic stability he forever boasts of having achieved—is to have succeeded in turning the tables on the Tories over the old issue of tax-and-spend. He could not have been clearer last week about where he wants the fault line in British politics to lie. On one side will be a Brown-led Labour government committed to “investing” as much as it sensibly can in “the national interest”; on the other, Conservatives who, for all the smooth words of David Cameron, are still intent on denying cherished public services the resources they need to better the lives of every citizen.

What should worry even those Labour MPs who would love to believe in Mr Brown's strategy is that the voters could begin to see the same dividing line in a rather different light. On one side of it stands a Labour government determined to get its hands on every pound that can be squeezed from them by an increasingly oppressive tax system. On the other side wait Conservatives who articulate their growing suspicion that Labour's vast injections of cash have done more to enrich the lives of those who work in the public sector than those who receive the services

it is supposed to provide.

The strike by local-government workers is a potent reminder of the extent to which this has already happened. Compared with other existing government employees—who, in a shameful ministerial cave-in last year, were guaranteed the continued right to retire at 60 on full benefit—they have a justified grievance (see article). But compared with most private-sector workers, who will probably have to work well past 65 for an uncertain reward, the strikers have no claim at all.

When Mr Brown talks about the public sector—or the "public realm", as he prefers to call it when waxing philosophical—he appears to see it as the embodiment of fairness and decency. In a recent speech, he spoke lyrically about the "men and women who, as is the essence of the labour movement, chose solidarity in preference to selfishness; thus creating out of the idea of duty and responsibility the Britain of civic responsibility, civic society and the public realm."

Yet in reality both the pension rights of public-sector employees and, in some parts of the country, their wages too have overtaken those in the private sector. With its indiscriminate largesse, the government has succeeded in making even family doctors unpopular, as they pocket £150,000-a-year ($262,000) salaries while reducing the hours their surgeries are open to patients. The four out of five people who work in the private sector and are forced to pay with their taxes for such generosity may struggle to share the chancellor's rose-tinted view of the public realm.

To be fair to Mr Brown, many of the mistakes, especially the more egregious pay deals, have not been his or his alone. Nor is he indifferent to getting value for the money that has been poured into health, education and other services. But up to now, his instinct has been to prefer Treasury-imposed targets and conventional top-down efficiency reviews to the systemic reform and bottom-up innovation that might yield better results.

Keep off the grass

What is almost as disturbing is Mr Brown's attitude to any internal debate on his policies. This week, a couple of the prime minister's close allies, Alan Milburn and Stephen Byers, both former ministers, dared to draw attention to the incentive-sapping effects of Mr Brown's complex tax and pensions credits. At about the same time, Bill Rammell, a Blairite education minister, suggested that "we are probably at about the limit of what people are prepared to pay to improve public services." The Treasury was "not in the habit" of responding to "statements made by backbench MPs", a spokesman said frostily; as for Mr Rammell, he "knows this government is committed to increasing investment in public services."

The consistency of Mr Brown's convictions, his self-belief and his sense of purpose are admirable. The flip side is over-confidence, inflexibility and insensitivity to the shifting temper of voters. If Labour MPs are not nervous, they should be.

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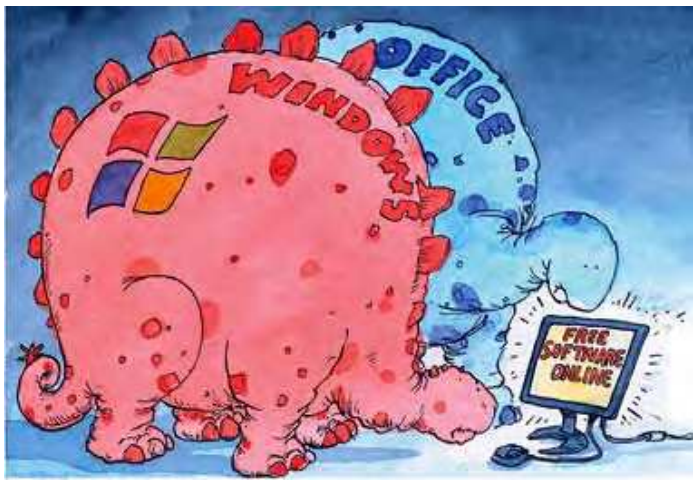
Microsoft

Spot the dinosaur

Mar 30th 2006 | REDMOND
From The Economist print edition

Microsoft's core business is under threat from online software



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RECENT advertisements for Microsoft show office workers as dinosaurs, stuck in a bygone era. Aptly, it is an accusation that some are now making about the software company itself.

Microsoft earns more than half its $40 billion or so of annual revenue—and the vast majority of its profits—on just two products: the Windows operating-system and Office, a collection of personal-computer (PC) applications including word-processing and spreadsheet programs. Both, however, are coming under threat from new technologies.

The pressure Microsoft is facing in its core businesses is similar to one confronted by IBM—another firm that was once synonymous with computing. At the beginning of the 1990s IBM had to face up to the shift from a computing world dominated by mainframes to one dotted by personal computers. In this new world hardware became a low-margin commodity and Microsoft's operating system took the privileged position. Today, Microsoft still dominates the PC market. But like IBM before it, today's giant knows that its position is under threat.

The threat to Microsoft comes from online applications, which are changing how people use computers. Rather than relying on an operating system and its associated application software—bought in a box from Microsoft, and then loaded onto a PC—computer users are increasingly able to call up the software they need over the internet. Just as Amazon, Google, eBay and other firms provide services via the web, software companies are now selling software as a subscription service that can be accessed via a web-browser. Salesforce.com, the best known example of this trend, offers salesforce management tools; other firms offer accounting and other back-office functions; there are even web-based word-processors and spreadsheets. This lowers the economic and technical barriers to entry for firms wanting to compete with Microsoft, as well as diluting the advantages the firm gets from controlling how the computer works.

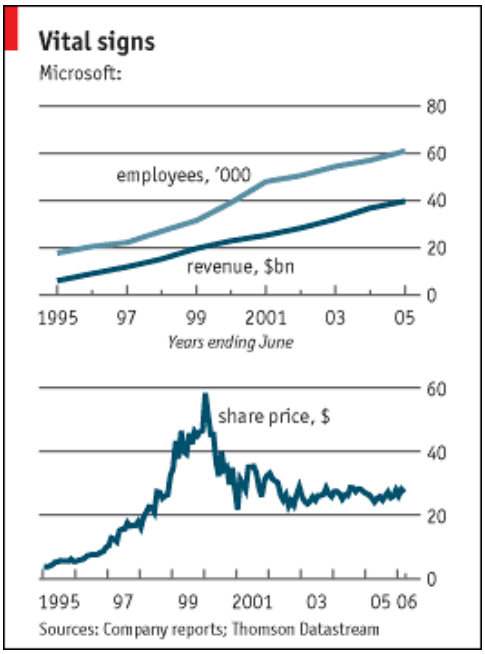
These huge shifts in computing take a very long time, because there is so much inertia in the marketplace—the idea of online applications has taken years to get even this far. Microsoft is still in a position that most firms would kill for. Its two main products—Windows and Office—remain fabulously profitable quasi-monopolies. Even if online applications and open-source software make rapid progress, Microsoft would retain a powerful and profitable position for some time.

For all that, however, online applications clearly threaten the way Microsoft makes its money. Its licensing agreements are geared for a world where software is a physical product, purchased on discs, and paid for at once or in regular instalments. But its online competitors charge each user a subscription: some like Google are even

supplying software as a free online service, financed by advertisements. Last month Google acquired the firm that created Writely, a popular online word-processing program that is an obvious potential competitor to Microsoft Word.

Online competitors have also mastered quick development and deployment times that Microsoft cannot match. Meanwhile open-source software—developed co-operatively and distributed free of charge—is also gaining ground. George Colony, the boss of Forrester, a technology-research firm, believes Microsoft faces the biggest challenge in the firm's history: “Bill Gates knows how to compete with anyone who charges money for products,” he says, “but his head explodes whenever he has to go up against anyone who gives away products for free.”

There are signs that Microsoft is feeling the pressure. In recent days the firm said that it would have to delay the introduction of both the next version of Windows, called Vista, and the next version of Office until early 2007. It also announced yet another re-organisation of its Windows division.



In an effort to respond to the new world it faces, Microsoft had already undergone a thorough management restructuring last autumn. Its seven business units were recast under three presidents, all of whom hail from the business side, not the technical one. Oversight of the sprawling Windows division was bundled alongside its internet unit, MSN, an admission of the importance that online services will play in operating systems in future.

At the same time, a relative outsider, Ray Ozzie, a veteran techie brought in last year, has created a stir by questioning why the most successful recent tech products, from Google search to the BlackBerry and the iPod, were not created by Microsoft. His remit is to see that the company reorients itself by adding an online component into virtually all its products. The first steps in that direction are “Windows Live” and “Office Live”. Microsoft, in short, wants to turn the rise of online software into an opportunity rather than a threat. “Before, we sold a cardboard box with a disk in it. We're now in a world where it is easier for us to sell add-ons,” says Charles Fitzgerald, a Microsoft executive.

Fortunately, Microsoft already has within the firm units that have demonstrated the agility and online awareness that the whole company now needs. The Xbox gaming unit boasts more than 2m paying subscribers for its Xbox Live service—which allows users to download games and entertainment and chat—and is the model for Windows Live and Office Live. Meanwhile MSN has captured a small share of the roughly $10 billion online advertising market. But the anchor products of Windows and Office, which in effect subsidise these ventures, have not evolved to reflect the new online era.

So Microsoft now plans to graft subscriptions, downloadable add-ons and advertisements on to its core products. Again, it portrays this as an opportunity to open up new revenue streams, rather than a defensive tactic. “There are three ways to pay for anything in this business: ads, transactions and subscriptions,” says Craig Mundie, one of Microsoft's chief technology officers. “You'll see the company offer a full range of different ways to buy our product.” The difficulty will be getting the timing right, so that new products do not undermine existing cash cows.

For now, however, too many Microsoft managers are still measured by their success with yesterday's business model—selling boxes of software. Microsoft is still formulating its response to the rise of online software. As one former Microsoft executive explains: the company's problems are not just technical but organisational. “It has a vision but not a roadmap; it can see the peaks but doesn't know how to cross the foothills to get there.”

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Telecoms and TV

The future is Now

Mar 30th 2006 | HONG KONG
From The Economist print edition

Hong Kong's incumbent telecoms firm has blazed a trail in television services

“JUST about every phone company in the world has come through here,” says Alexander Arena, the finance chief of PCCW, Hong Kong's incumbent telecoms company. And no wonder. For PCCW has, in the past couple of years, done something that fixed-line telecoms firms across the world hope to do in the near future. It launched a television service over broadband phone lines, called Now Broadband TV, that has been a huge commercial success. It could soon dethrone the local cable-TV firm as the dominant provider of pay-TV services. It is also the largest television-over-broadband deployment in the world. As they worry about the encroachment of new competitors on to their turf and search for new sources of revenue, telecoms operators the world over hope to follow Now's example.

Why has it been such a success, and can its approach be replicated elsewhere? When Now unveiled its service in September 2003, Mr Arena recalls, “analysts proclaimed us roadkill”. That was because PCCW had attempted to launch television services twice before, in 1996 and 2000, failing expensively both times. But these attempts paved the way for Now, since they meant that PCCW had built a fast, fibre-optic network capable of carrying television signals into telephone exchanges. They also meant that PCCW had learned from its mistakes.

In particular, Now knew better than to settle for the usual terms offered to cable operators, which are expected to pay big up-front fees for film rights, in part to cover the content providers against piracy. Unlike cable networks, however, broadband phone lines have enough capacity for only one television channel at a time, so channel switching is done at the exchange, not inside the set-top box. This makes piracy almost impossible, and also allows for the collection of extremely detailed viewing statistics. The combination of security and feedback convinced content providers to agree to an “à la carte” model, in which Now subscribers can choose whether or not to subscribe to each individual channel, rather than being forced to pay for a whole bundle. This was much more flexible than the rival offering from the incumbent cable-TV firm. Now started with ten free channels, and allowed subscribers to choose which additional channels, if any, to pay for on top. Viewers can even sign up for new channels on-screen.

Now also took the unusual step of developing its own set-top box, based on a stripped-down DVD player and produced very cheaply in China. This enabled it to begin its service without waiting for industry standards to emerge. It offered the box free of charge to broadband customers, 93% of whom now take the TV service as well. As its subscriber base grew—it exceeds 500,000, or more than 40% of the market—Now was able to poach valuable content, such as sports rights and film channels, from rival pay-TV operators. It recently launched a films-on-demand service, and on March 20th its own Chinese-language business channel.

PCCW is advising telecoms firms in Malaysia, Indonesia, Thailand and eastern Europe on how best to emulate its strategy. Another partner is China Netcom, which plans to launch TV services based on Now's model in two Chinese cities with populations of 6m or so, comparable to that of Hong Kong. China has 100 more such cities, notes Mr Arena.

But some observers are sceptical. While aspects of Now's model can be applied elsewhere—such as the use of “à la carte” pricing as a competitive weapon—in some ways it is unique, says Bertrand Chui, an analyst at ICEA Securities. “Hong Kong is a very small place, so it is relatively cheap to roll out really fast broadband access,” he says. The high population density, with people packed into high-rise apartment buildings, reduces network costs. The savings enabled Now to give away set-top boxes and pay more for content. Operators in other countries may not be able to do the same.

Furthermore, notes Windsor Holden of Analysys, a telecoms consultancy, a “one size fits all” approach is unlikely to work across Europe, so telecoms firms in different countries will have to tailor their approaches. They also face a cultural challenge, notes Mr Holden, as they move into television. “Whenever you get telecoms companies and broadcasters coming together, you're going to get trouble,” he says. Worryingly, that may highlight another secret of Now's success: there is no substitute for learning by experience.

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Texting

Hot to trot

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A new service hopes to do for texting what Skype did for voice calls

TALK is cheap—particularly since the appearance of voice-over-internet services such as Skype. Such services, which make possible very cheap (or even free) calls by routing part or all of each call over the internet, have forced traditional telecoms firms to cut their prices. And now the same thing could be about to happen to mobile-phone text messages, following the launch this week of Hotxt, a British start-up.

Users download the Hotxt software to their handsets, just as they would a game or a ringtone. They choose a user name, and can then exchange as many messages as they like with other Hotxt users for £1 ($1.75) per week. The messages are sent as data packets across the internet, rather than being routed through operators' text-messaging infrastructure. As a result, users pay only a tiny data-transport charge, typically of a penny or so per message. Since text messages typically cost 10p, this is a big saving—particularly for the cost-conscious teenagers at whom the service is aimed.

Most teenagers in Britain, and elsewhere in Europe, pay for their mobile phones on a “pre-paid” basis, rather than having a monthly contract with a regular bill. Pre-paid tariffs are far more expensive: bundles of free texts and other special deals, which can reduce the cost of text messaging, are generally not available. For a teenager who sends seven messages a day, Hotxt can cut the cost of texting by 75%, saving £210 per year, says Doug Richard, the firm's co-founder. For really intensive text-messagers, the savings could be even bigger: Josh Dhaliwal of mobileYouth, a market-research firm, says that some teenagers—chiefly boys aged 15-16 and girls aged 14-15—are “supertexters” who send as many as 50 messages per day.

While this sounds like good news for users, it could prove painful for mobile operators. Text-messaging accounts for around 20% of a typical operator's revenues. With margins on text messages in excess of 90%, texting also accounts for nearly half of an operator's profits. Mr Richard is confident that there is no legal way that operators can block his service; they could raise data-transport costs, but that would undermine their own efforts to push new services. Hotxt plans to launch in other countries soon.

“The challenge is getting that initial momentum,” says Mr Dhaliwal. Hotxt needs to persuade people to sign up, so that they will persuade their friends to sign up, and so on. Unlike Skype, Hotxt is not free, so users may be less inclined to give it a try. But as Skype has also shown, once a disruptive, low-cost communications service starts to spread, it can quickly become very big indeed. And that in turn can lead to lower prices, not just for its users, but for everyone.

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Intellectual property in China

The boot is on the other foot

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China discovers the virtues of intellectual property

A COURT case involving counterfeits and China is nothing new—except this time, it is the Chinese company that is doing the suing. In February Netac, a company based in Shenzhen, took PNY Technologies of New Jersey to court in Texas and so became, it is thought, the first mainland firm to sue an American one for patent infringement.

Netac claims that PNY has infringed its patent for external flash-memory storage devices, also known as “flash drives” or “key drives”, which have replaced floppy disks as the easiest way to carry data around. It is seeking “significant” (though unspecified) financial damages. The Chinese company obtained a Chinese patent for its technology in 2002 and an American one in 2004. PNY, it says, infringed the later patent, stunting Netac's growth in the American market for flash drives, which is worth more than $2 billion a year and growing fast. According to Gartner Dataquest, a consultancy, Netac ranked only sixth in this market in 2004 with a 4.4% market share, behind an array of Asian and American rivals including SanDisk, M-Systems—and PNY.

Litigation, alongside memory chips, appears to be turning into a bit of a speciality for Netac. Over the past three years, the firm has brought patent suits against Hua Qi, a Beijing-based local competitor; Acer of Taiwan; and Sony of Japan. Hua Qi lost, but is appealing; Acer has settled; and the Sony suit is ongoing. On the other hand, 19 international manufacturers have protested that Netac's patents are too broad, though around ten others, including Samsung Electronics of South Korea, have been happy to license its technology.

Netac is likely to prove a harbinger. As Chinese companies develop their own patents, copyrights and trademarks and seek to protect them, China as a whole will become more sensitive to the protection and enforcement of intellectual property rights (IPR). “It is an encouraging sign that Chinese companies have become mature in using IPR to protect their interests,” Hu Zuochao, vice-president of the Patent Protection Association of China, told the Chinese media.

If China is indeed taking intellectual property more seriously, that could also be good for foreign investors. The American government estimates that Chinese violations of foreigners' IPR costs international firms at least $60 billion a year—as much as the entire annual foreign direct investment into China. But comments such as Mr Hu's may also be a signal of what Lester Ross, a lawyer in Beijing, calls a rising tide of “techno-nationalism”. He predicts growing security fears and resentment over foreigners earning royalties from technology that China could produce itself. This will drive many more Chinese firms to sue foreign ones over patent rights, thinks Mr Ross—who points out that Chinese firms are increasingly confident about using the American courts to fight contract and payment disputes. New Chinese interest in the protection of intellectual property might help foreigners. Then again, it could just mean higher legal bills.

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Canadian doughnuts

Sticky fingers

Mar 30th 2006 | TORONTO
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Canada discovers an answer to Google

WHEN Wendy's International, an American fast-food firm, spun off a small slice of Tim Hortons, a coffee-and-doughnut chain, on March 24th the reaction among Canadian investors was so frenzied that market analysts compared it to the launch of Google. Brokers reported anguished calls from retail clients begging for a piece of the action. Within hours of its debut on both the New York and Toronto stock exchanges, Tim Hortons' stock had rocketed upwards by 41%, although it later fell back a little.

There was more than potential profit fuelling the Canadian frenzy. Tim Hortons, co-founded in 1964 by a National Hockey League player of the same name, is regarded as a Canadian national institution, even though Wendy's has owned it outright since 1995 and retains 82.7% of the Delaware-based company after last week's sale.

The chain dominates the Canadian fast-food market. It has 2,597 outlets—more than any of its competitors including McDonald's—and a 22% share of fast-food sales. Canadians boast of eating more doughnuts each than any other nation in the world. It is also part of the country's social fabric: politicians kick off election campaigns in doughnut shops, or make sure they are photographed with a cup of Tim's coffee. Canadian soldiers in Afghanistan pleaded to have an outlet on their base. And in a less wholesome tribute, Karla Homolka, wife of Paul Bernardo, a notorious serial killer, put an iced cappuccino from Tim Hortons at the top of her wish list when her prison term ended.

But when you are at the top of the doughnut heap, where do you go from there? The company maintains there is still room for another 1,000 to 1,500 outlets in Canada, mainly in the booming western provinces that have not yet been saturated with a Tim Hortons on every corner. There is one outlet for every 8,707 people in Ontario, compared with one outlet for every 18,906 people in the western provinces.

However, the real challenge is America, where the company has a mere 288 outlets, concentrated heavily in the border states. In America Tim Hortons is up against bigger, better-known brands and a clientele that drinks less coffee (and cares less about hockey) than its loyal Canadian customers.

And while the American market may be appetising, it is already well supplied with sugary fried bread. The north-east belongs to Dunkin' Donuts. The 68-year-old Krispy Kreme has a nationwide claim. It enjoyed a meteoric stockmarket listing in 2000—but, after hitting a high of almost $50 in 2003, Krispy Kreme shares today trade at only $9. Meanwhile, a trend towards gourmet doughnuts has set in. In Seattle, birthplace of Starbucks, the chic Top-Pot doughnut shop sells “hand-forged” doughnuts.

Gourmet doughnuts could be a promising niche. But Americans have recently married their obsession with obesity with their love of litigation—by suing firms that make them fat—now may be a risky moment for Tim Hortons to fry south.

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Airbus and Boeing

Testing times

Mar 30th 2006 | TOULOUSE
From The Economist print edition

Airbus has a small problem in the market for big jets

Get article background

AIRBUS was delighted with the results of an evacuation test for its double-deck A380 on March 26th. Although one person broke a leg and others suffered minor injuries, 853 passengers were evacuated in the dark with half the doors blocked in 90 seconds—fast enough to satisfy safety regulators. Otherwise the aircraft would have faced further delays to its entry into service, already pushed back six months to the end of this year, because of problems wiring the in-flight entertainment system.

The real test looming, however, will come from the market. Orders for the giant A380 have slowed to a trickle. Total orders of 159 are 100 short of the number at which the company breaks even. Airbus is sticking to its development figure of $11.7 billion, but there are rumours of over-runs. Nor is the company expecting many more orders until the aircraft enters service at the end of this year, first with Singapore Airlines followed by Emirates.

The A380 is designed to fly around 555 passengers between hub airports, such as London and Singapore, on routes that are crowded because of limited runway capacity. Airbus is hoping that long-haul carriers that have yet to show any interest in the plane—such as British Airways and Cathay Pacific—will eventually be swayed by the plane's success in the market. The A380 promises cheaper costs per seat than other long-haul aircraft for airlines that manage to fill them. But most airlines seem to be planning on installing barely 500 seats, which suggests that they are going to make use of the plane's spacious interior to create lounge bars and recreation areas. Even if rumours about casinos and in-flight gyms turn out to be marketing hype, the idea is to make long-haul travel more tolerable.

Boeing is concerned enough about the challenge from the giant Airbus plane to be bringing to market an enlarged version of its venerable 747, capable of carrying 450 passengers (34 more than today's planes). Boeing reckons, however, that the big growth will come from smaller planes, carrying 250-400 passengers. These will enable people to travel direct rather than changing at hubs. Airbus sees the value of this too, but it has been so busy designing the A380 that its smaller models have been neglected. That has exposed it to a counter-attack from Boeing, which is rebounding sharply after being outsold by Airbus for the past five years. Although Airbus sold more planes in total than its rival last year, Boeing enjoyed a 70% share of a booming market in widebody, long-haul aircraft (where margins are better) .

Airbus has a rival (the A350) to Boeing's latest hope, the 250-seater 787. But the Airbus offering will come to market only in 2010—two years after Boeing's. Meanwhile the European firm is losing out in the next size up, where Boeing sold 155 of its 777 long-haul planes last year, compared with only 15 Airbus A340s, which suffers from having four engines in a time of high oil prices.

Airbus's dilemma now is a classic marketing problem: should it spend more money to improve the A340 or slash its price? Airbus bosses will spend the next few weeks reviewing whether it is worthwhile transferring technology, including engines, from the coming new A350 to revive the larger older plane, or whether they should let it wither on the wing. Meanwhile they are putting pressure on Boeing in the contest between the long-haul 250-seaters, the A350 and the 787: this week it emerged that Boeing is now going to offer a larger version to compete with the higher capacity Airbus rival.

The good news for travellers and airlines alike is that the two producers that bestride the market for big jets are now competing on more than price. They are also slogging it out on quality and product innovation, bombarding each other with new designs. As the offensive continues, passengers over the next few years are bound to get nicer, quieter aircraft.

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News Corporation

Murdoch's space

Mar 30th 2006
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Despite a backlash, MySpace and its advertising revenues are growing fast

myspace.com

Space cadets

RUPERT MURDOCH'S purchase of MySpace.com, a social networking site, was hailed as a triumph last year: it had 16m visitors in July 2005 when News Corporation bought it, and by the end of the year had 29m. Rival "old" media bosses looked on enviously as with one swoop Mr Murdoch's firm established itself among the giants of the internet.

But MySpace's enormous popularity with teenagers has also brought the worst kind of controversy: a number of cases where men have picked up under-age girls. MySpace consists mainly of millions of home pages where young people show off with often provocative pictures of themselves (*Playboy* magazine will soon run a "Girls of MySpace" photospread), music, blogs and links to friends. Many parents in America are furious about the site. Lots of schools are banning it, in part because teenagers are using it to be rude about teachers.

Ominously for News Corporation, advertisers have become nervous. Indeed, MySpace now has a well-established ad cycle of its own, says Rob Norman, of WPP, an advertising giant. "A marketing boss reads a newspaper article about how fashionable it is and says 'oh my God we've got to be there', then reads another article that scares the living daylights out of him and the company pulls the campaign and beats up its media buyer for ever putting them on it." The site has even been linked to terrorism—ABC, a TV network, has suggested (without citing evidence) that al-Qaeda may use it to communicate.

MediaPost, an online trade journal for media buyers, claims some advertisers are already avoiding MySpace. It would be a big blow for News Corporation if lots of advertisers boycotted it. The firm spent $580m to buy MySpace. At the time, media executives were surprised that Mr Murdoch, a conservative newspaper man, would choose a racy, left-leaning social network at the forefront of the trendy "Web 2.0" movement. The firm is now working hard to prove that it can make plenty of money from MySpace's traffic. To a large extent, Mr Murdoch's new internet strategy hangs on the site's success.

News Corporation has responded quickly to try and protect MySpace's youngest users. It will appoint a safety "tsar" to oversee the site. As for advertisers, Ross Levinsohn, News Corporation's head of new media, says that some have expressed concerns. But he points out that advertising revenues are doubling every half year. Plenty of prominent advertisers, such as Toyota and Wendy's are using the site, and Hollywood is using it to create buzz about films. Richard Greenfield, an analyst at Pali Research, agrees: MySpace is now earning advertising revenues of about $13m a month, he points out. Provided that the company takes propriety seriously, says Mr Greenfield, MySpace will continue making money.

Although some admen are warning against the site in public, many of their clients are in fact staying on it. MySpace, after all, captures the attention of young people, whom advertisers are struggling to reach through television and other traditional media.*MediaPost* recently quoted David Cohen, executive vice-president at Universal McCann, an ad agency, saying that he “wouldn't be caught dead in that kind of environment”. Nevertheless, several of his firm's clients advertise on MySpace.

The key to using it safely, says Mr Cohen, is to stick as much as possible to the bits of the site that News Corporation builds, and to tread carefully when placing brands near unpredictable “user-generated” content. Universal McCann has also negotiated the ability to pull down ads in one to two days, more quickly than the usual two weeks' notice. “We can be out of there in a heartbeat if need be,” he says.

Another attack on MySpace has come from Jupiter Research. One of its analysts, Nate Elliott, has said that one of the website's favourite statistics, its 55m or so registered users, is a “mirage”. Half of people who sign up to social networks stop visiting after a month or so, he says. And although MySpace's unique user and page view numbers are impressive, he says, the likelihood is that a small share of its visitors generates most of the page views. Advertisers would not want to pay as much to reach the same smallish group of people thousands of times a month.

Mr Levinsohn says that Jupiter has no data to support its claim. Because what Mr Elliott is saying is potentially damaging to MySpace's business, he adds, he has made a call to the firm's chief executive to demand an explanation. Meanwhile, in the time it took to read this article, about 400 people have joined MySpace.

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Face value

A barbarian no more

Mar 30th 2006
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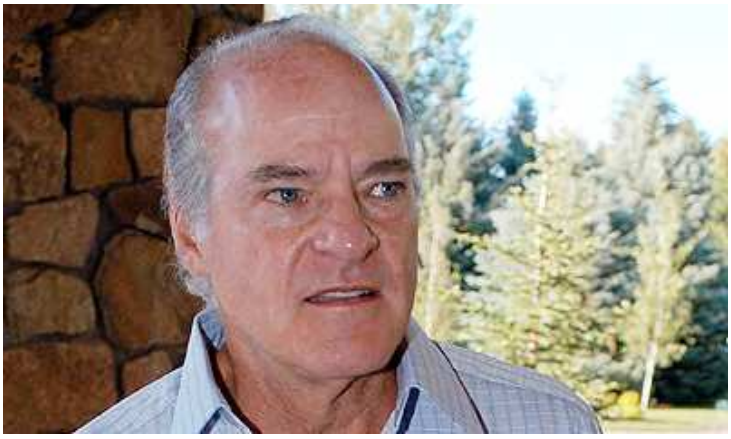
After 30 years in private equity, Henry Kravis has become the acceptable face of capitalism

Eyevine



HENRY KRAVIS has no immediate plans to retire. That much is clear. One by one, the founding fathers of the private-equity industry have been passing control of the firms they built on to their successors. Last week Thomas Lee left his eponymous private-equity firm, under something of a cloud. Sir Ronald Cohen has retired from Apax Partners. Teddy Forstmann is calling an end to his firm, Forstmann Little, as well as his own career.

But Mr Kravis, now 62 years old, the most famous of all private-equity investors, and his comparatively reticent cousin, George Roberts (61), remain determinedly in charge at Kohlberg Kravis Roberts (KKR), the firm they have jointly run for so long. Indeed, say people close to them, the pair are more committed than ever—so much so that last September two KKR partners viewed (at least by outsiders) as the heirs-apparent quit to start a private-equity firm of their own.

Mr Kravis has no need to work. According to *Forbes*, he is worth $2.5 billion. That and his easy Southern charm have put him at the heart of New York high society. A centrist Republican, a few years ago he co-founded the Republican Leadership Council to promote fiscal responsibility and moderate social policies. Like many of Wall Street's newly wealthy, he is an active philanthropist. He has made huge donations to education and medicine and, with his third wife, is active in the arts. He also famously enjoys the good life; the spectacular home he shared with his second wife was parodied in the 1990 film of Tom Wolfe's "Bonfire of the Vanities".

Unfortunately for Mr Kravis, his name will forever be associated with "Barbarians at the Gate", the bestselling book about KKR's battle in 1988 to buy RJR Nabisco for $25 billion. That record-breaking leveraged buy-out (LBO)—then the highest price paid for a public company—earned KKR big fees but made no money for its investors. It became a lightning rod for public unease about financiers borrowing huge sums of money to acquire venerable firms, only to slash jobs and sell off the business in pieces so as to raise the money they need to repay the debt.

Although deals today have a much lower ratio of debt to equity, and KKR and its peers wisely call themselves private-equity—not LBO—firms, the public image of the industry as essentially barbarian lingers on, especially in its newer outposts. Mr Kravis is doing his bit to change this. In February he gave a speech in Germany, turning his charm on critics who have labelled private-equity firms there "locusts". On the contrary, argued Mr Kravis, private-equity investing "leads not only to value creation but also to economic and social benefits, for example, increases in employment, innovation, and research and development". The archetypal American capitalist even wrapped himself in the language of German stakeholder capitalism. "We at KKR are very strong believers in looking out for all stakeholders," he said, including employees, customers, suppliers, shareholders and the community.

Mr Kravis has a point. Despite its public image, the industry he pioneered has a record of building companies and creating jobs over the long term. Its performance compares increasingly well with that of publicly quoted companies, which after the corporate scandals at the start of this decade now combine short-termism, weak

governance and, especially in America, burdensome regulation.

Built to last?

KKR is busily raising a new fund that may exceed the record-breaking $13 billion fund now being closed by the Blackstone Group. That reflects the exalted status both of the private-equity industry and of KKR within it. Yet, until recently, the firm's best days seemed behind it. After the RJR Nabisco deal, the industry stagnated, and even when activity started to pick up in the mid-1990s, KKR performed patchily.

So, in the late 1990s, Messrs Kravis and Roberts decided to give their own firm the private-equity treatment, thoroughly restructuring it to improve its performance. They decided to globalise KKR, moving first into Europe and then into Asia, where Mr Kravis has lately spent much time. KKR had become a victim of its own success, its methods having been widely imitated. Capital was plentiful, so it needed to find distinctive ways of adding value. According to Mr Kravis, that meant acquiring expertise of working in industries to complement the financial expertise now on offer at every private-equity firm. KKR has added several former bosses of industrial companies to its roster of partners. It has also sought to restructure acquisitions as soon as they are bought. Working with its in-house consulting firm, Capstone, KKR has pioneered the use of detailed “first 100 day plans”—something that every other private-equity firm nowadays feels obliged to claim that it does, too.

On the face of it, this has been a triumph. The KKR Millennium Fund, which started to invest in 2002, has so far earned an internal rate of return of more than 40%—as good as KKR has ever produced. Yet, for all Mr Kravis's talk of private equity entering a new era, where finance is a commodity and operating expertise matters, the recent great results are due, overwhelmingly, to being in the right place in the financial markets at the right time: loose credit markets have made the leverage of private equity a licence to print money.

The real test of KKR's new strategy will come in the harder market conditions that surely lie ahead—of tighter, pricier credit and perhaps an economic slowdown. One characteristic of those people history judges to be great leaders is timing: the ability to step aside at the moment of greatest triumph, leaving a successor to grapple with the tougher times ahead. Given the difficult outlook for the private-equity industry, perhaps Mr Kravis should retire now after all, while his standing is so high.

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DaimlerChrysler

In tandem (at last)

Mar 30th 2006 | DETROIT AND STUTTGART
From The Economist print edition

It has taken eight years, billions of dollars and blood on the carpet, but a big merger is finally starting to work

AP

Get article background

A GIANT metal three-pointed Mercedes star dominates the hillside above the Neckar valley and the industrial town of Stuttgart, capital of prosperous Baden-Württemberg in south-west Germany. The star revolves on top of a light and airy office complex in the sleepy suburb of Möhringen. For more than a decade this has been the head office of Daimler-Benz (which was later renamed DaimlerChrysler), the proudest of German industrial giants. The Möhringen office was opened by Edzard Reuter, a distinguished politician and intellectual who ran Daimler-Benz for eight years from the mid-1980s, as the symbol of an expanding corporate empire.

Mr Reuter's dream was to turn Mercedes-Benz, arguably the world's best cars, into an “integrated technology concern”. He bought companies that made planes and trains, cookers and fridges, and he diversified into finance and computers. The head office on the hill soon reigned over famous German industrial names such as Dornier, MTU and AEG, in addition to Fokker in the Netherlands and Cap Gemini in France.

It was a spectacular binge; it was also a flop. The company's share price plumbed new depths even as Germany's stockmarket boomed. Mr Reuter's successor, Jürgen Schrempp, started dismantling the empire bit by bit, selling the trains and the planes and the computer-software interests. There was less talk of “integration” and more about what to do to bolster the car company at the core of the group.

Pretty soon Mr Schrempp was building an empire of his own. A former car mechanic, who had risen through the ranks running the Mercedes business in South Africa, he wanted to turn Mercedes from a European regional maker of premium saloons into a truly global carmaker with a big presence in America. In 1998 he took over Chrysler to convert Mercedes into a global heavyweight with a wide range of products and markets. His reasoning was that, as competition became tougher, even premium brands such as Mercedes needed greater volume to support the increasingly expensive technological development required to stay ahead. Strategically, it was the right step to take. Rivals such as the head of BMW lauded his courage and admired the strategy. Ford Motor's boss never forgave Mr Schrempp for not tying the knot with him instead. The only problem with the Schrempp strategy was getting it to work.

Next month Dieter Zetsche, Mr Schrempp's successor, will go even further back to basics when his top managers move out of Möhringen to squeeze into a jumble of offices around the giant Untertürkheim engine factory, one of the oldest Mercedes factories, down in the industrial valley. Only some administration offices will remain up on the hill. Mr Zetsche explains the reasoning for the move: “There used to be an atmosphere of them and us,” he says, referring to the Daimler-Benz people on the hill and the car business people of Mercedes at the factory. “To

overcome it, we decided we needed a symbol that we were one automotive company making cars and trucks every day, morning, noon and night."

But the move is more widely symbolic. At one level it dismantles the last remnants of the conglomerate superstructure that survived even the legal integration of Mercedes-Benz into Daimler-Benz nine years ago. It is also a sign that the German end of the DaimlerChrysler group is being sorted out in the same way that the Detroit part has been, painfully, over the past five years. Over the next three years some 6,000 white-collar jobs will be eliminated (equivalent to one-fifth of the total); the removal of duplication will cut one in three management jobs.

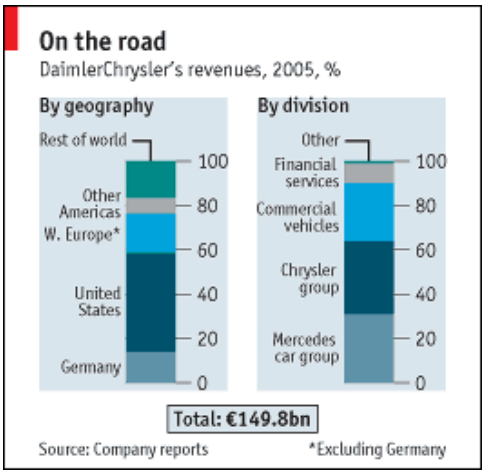
While attention focused on fixing Chrysler's operations and integrating the technical and engineering work behind two vastly different brands and businesses, Mercedes itself slipped badly. Its reputation for quality was dented by unfavourable consumer reports following problems with some diesel pumps and electronics in the big-selling E class saloons. Even when managers got round to fixing these problems, they allowed themselves to be distracted from an equally serious deficiency. Rising costs could no longer be sustained in a more competitive market. The company's move downmarket into small cars was an expensive failure, as its Smart cars piled up huge losses amid falling sales. Today it is the turn of Mercedes to be in the repair shop for an overdue service, after a long and arduous journey for the DaimlerChrysler group. Last year the Mercedes division lost €505m ($627m), its first loss in more than a decade.

Marriage made in heaven—or hell

When the marriage of Daimler-Benz and Chrysler was announced in May 1998, it was the biggest cross-border industrial merger ever. More than any other, it was the deal that gave a practical meaning to globalisation. A leading car company in Europe and one in America acknowledged that it could not prosper without acquiring greater scale to deal with the consequences of the globalisation of its industry. It was the biggest upheaval that the car industry had seen, and was soon to inspire the equally globe-spanning alliance of Renault and Nissan.

When the deal was consummated later that year it created an industrial giant with global sales of more than $150 billion and a group that ranked fifth among car manufacturers. No longer was Chrysler to be the straggling third of the Detroit Big Three; no longer was Daimler-Benz a specialist producer of premium saloons struggling to widen its product range. Their combined strengths would make the group fit to take on the world.

That was the theory. The practice has proved much messier. DaimlerChrysler's share price fell from a peak of $108 in January 1999 to $38 by November 2000. The combined group was worth barely the value of Daimler-Benz before the merger. Today the price is still only half the level reached in the post-deal euphoria. The marriage made in heaven soon turned into the hitch-up from hell, as billions of dollars of shareholder value was destroyed. Soon, new problems at Chrysler were adding to investors' concerns that integrating the two companies was hard.



From the start, the combined company was wracked by divisions at all levels. Neither side could agree on whether this was a genuine merger of equals or a quiet takeover of an American company by a financially stronger German one. For at least a year the group had two chairmen, Mr Schrempp from Daimler and Bob Eaton, who had been boss of Chrysler. Mr Eaton was weakened after he said he would retire early, making him a lame duck from the outset.

Despite months of meticulous planning and years of effort, the integration of two very different ways of working has still not fully taken place. True, the Germans learnt to be less formal and to cut back on their proclivity for piles of paperwork, while the Americans learnt more discipline in their decision-making and meetings. One mistake the Germans made was to keep away from Detroit—one reason why head office in Stuttgart was slow to grasp that the American end was going awry. Rather as BMW bosses failed to get to grips with Rover after the German company bought the ailing British volume car producer in 1994, so the Germans of Daimler were probably anxious not to be seen to be heavy-handed.

The first couple of years were consumed by struggles over who was really in control and over how the combined companies were to be run. Although billed as a merger of equals, it was nothing of the sort—as later became clear. Daimler could not afford to choose a merger formula, for instance, with a jointly owned company based in the Netherlands, since that would have triggered a huge tax charge. So Chrysler had to become part of a German *Aktiengesellshaft*. In compensation for this agreed takeover, the Chrysler shareholders were paid a 28% premium over the then market price (even though managers maintained the "merger" fiction resolutely thereafter).

In time, these inevitable barriers to integration might have been surmounted smoothly. But the group ran into

difficulties on both sides of the Atlantic. Although Chrysler had been the most profitable car company in the world in the mid-1990s, weaknesses surfaced like rust on an ageing car body shortly after it merged with Daimler.

Within a year of the deal taking effect in November 1998, the American boss of Chrysler was fired. His successor lasted barely a year, as Chrysler swung from a profit of $2.5 billion in the first half of the year to a loss of $2 billion in the second. Tougher market conditions had exposed shortcomings in the company's product line, which failed to offer enough models to cover increasingly fragmented demand. Mr Zetsche and Wolfgang Bernhard were flown in from Germany to wield the axe.

Nobody foresaw that it would take a crisis at Chrysler to catalyse the belated integration of the two companies. First a crack German executive had to be imported to sort out the American company; now the same man, with five years' experience in America under his belt, has moved back to Germany to run both the whole group and the Mercedes division.

“You can see now that it clearly was a takeover,” quips Mr Zetsche, “now that a Chrysler guy is running the show here in Stuttgart.” Such a joke would have been seen as too sensitive even a year ago. Now it is one indication that the two companies have finally become one.

Toil and trouble

Mr Zetsche recalls that on arriving in Chrysler's headquarters in Auburn Hills outside Detroit, he found a company with problems in every department: “Chrysler in 2000 was a company that had lost it.” Productivity was hopelessly out of touch with the industry's norms. Each vehicle took Chrysler around 40 hours to make, compared with 20 or so for the American factories of competitors such as Honda and Toyota. Purchasing was inefficient and fixed costs were far too high for a company of its size. Investment was running at 10% of sales but, even then, was failing to fill the gaps in a weak product line. Quality control was a constant problem. Worse, says Mr Zetsche, “there was no glide path towards fixing these things.” Tom LaSorda, who succeeded Mr Zetsche as boss of the Chrysler division, recalls the crisis even more bluntly: “We were investing more than GM, even though they were twice the size; it was a path towards going bankrupt, and we are still paying for some of those expenses.”

The Zetsche recovery plan set a target of 30 hours a vehicle by 2007; last year the time was down to 33.6 hours and the latest figure, due out in June, will show further improvement. A five-year capital-spending plan of $42 billion was slashed to $29 billion, but the number of new products in development rose by 50%, because capital was deployed so much more efficiently. The time to bring forward new models fell from two years to only 17 months. Some big costs such as body-stamping dies were slashed by 40%, says Mr LaSorda. Chrysler shrank to fit the number of cars it could sell: it shut six factories and cut 45,000 jobs, a third of the total.

Chrysler also began to benefit from Mercedes's technology. According to Frank Klegon, head of product development at Chrysler, technology-sharing among engineers started right after the merger, despite integration problems in top management. The biggest pay-off has been in the Chrysler 300 model, which has been a runaway success. With its German rear-wheel-drive technology, it even feels like a Mercedes to drive. Not only have its soaring sales boosted revenues and profits, but its stylish and raunchy image has done wonders for the Chrysler brand, moving it upmarket. The car deliberately draws on Chrysler's 1960s heritage of big muscular cars and powerful, smooth engines. The Dodge Charger, the Jeep Commander and the Dodge Ram Mega Cab were among 15 new products to be launched in the past two years; a further ten are to hit the market this year.

A new dawn

Today Chrysler is the healthiest of the car companies in Detroit, with a brand that has moved upmarket even as surplus capacity and workers were shed. The Mercedes division is now undergoing the same tough restructuring. Mr Zetsche took the top job in January, having made his reputation turning around Chrysler. He is also chief executive of the Mercedes car group, charged with the attempt to recover its status as Germany's leading luxury car brand—a title ceded to BMW a couple of years ago.

But such is competition in the American market, where Chrysler sells most of its 2.8m vehicles a year, that even its newly strong product line is facing problems. People in the industry estimate that Chrysler will have had to slash production by 10-13% in the first quarter, compared with a year earlier, because its inventories have built up. Chrysler's healthy profit increase last year was boosted by exceptional factors, and the underlying profit in the fourth quarter fell. The company is talking to the unions about further cuts in health-care costs. Chrysler has a better record than its bigger rivals, GM and Ford, when it comes to negotiations with the unions. It should reap benefits from the concessions those two companies are now beginning to win from the United Auto Workers union. The signs are that the UAW is frightened enough by the dismal prospects of the Detroit Big Three that it is prepared to make concessions even before the company contracts come up for renewal next year.

Walk round the big Mercedes car factory at Sindelfingen outside Stuttgart and the scene looks like any other. The vast complex churns out 2,100 cars a day and employs more than 42,000 people. But the pace is relaxed.

Mercedes luxury cars are available in so many specifications that no two cars going down the line are the same. Mercedes uses thousands of robots to cut expensive manpower. You see the same red robots, made by a German supplier, in Chrysler's American factories: bulk buying like this is one practical way to take advantage of the quadrupling of vehicle output that came with the merger of the two companies. With BMW expanding and Volkswagen eating into its sales with trendy upmarket Audi models, Mercedes now has to cut costs to become profitable again. A plan started last year should produce €1.5 billion of annual cost savings and more are in the works. Already, more than 5,000 workers at its German factories have taken voluntary redundancy or retirement packages. A further 3,500 are to go by September this year.

With the savings coming from a single head office and more efficient Mercedes production, DaimlerChrysler is now focusing on its remaining problem, the Smart car brand. Mercedes joined forces with the inventor of Swatch watches more than ten years ago to produce cute little town cars, using revolutionary techniques. An aluminium space frame forms the core of the vehicle, with pre-painted plastic panels hung around it. But the Smart vehicles have never fulfilled their designers' hopes and the division is a perennial loss-maker. A “For Sale” notice was pinned on it last year, but for the moment no takers have stepped forward. The product range is being pared back, with the end of a four-seater Smart model. Mr Zetsche is redoubling efforts to make the group profitable by next year, saying he will do whatever it takes for this to happen. After allowing about €1 billion for provisions to cover cut-backs and losses last year, DaimlerChrsyler announced at the end of March that it is pouring as much again this year into fixing Smart.

Another post-merger crisis to dog Mr Schrempp emerged in Asia. Nissan became available as a potential partner in early 1999, but after some talks the Germans decided they had enough on their plates absorbing Chrysler. Nevertheless, a year later DaimlerChrysler did invest €2.1 billion for a 34% stake in Mitsubishi Motors. But, after a scandal erupted at the small Japanese manufacturer over concealed quality problems, the DaimlerChrysler board rejected Mr Schrempp's call for them to invest more money in a re-financing of Mitsubishi. The result was a total exit from the Japanese company last November. Unfortunately, this has resulted in the almost complete collapse of Mr Schrempp's Asia strategy, leaving DaimlerChrysler scrambling to catch up in markets such as China where it has been slow to take advantage of growth.

You can run

The big lesson of the formation of DaimlerChrysler is that grand strategy is never going to shield a company from problems, whether these are the consequences of something as ambitious as a transatlantic merger, or the weaknesses of parts of the business. With hindsight, it is clear that when Daimler-Benz went into the merger it was gloriously unaware of the fragility of Chrysler's apparently stellar performance in the late 1990s. In America in 2000, as soon as the Asian brands became rival suppliers of the light trucks and SUVs on which the company made all its money, Chrysler's profits collapsed.

After two wasted years before getting to grips with Chrysler's woes, Daimler people neglected growing problems back home in Germany, where the once-unassailable tri-star brand was losing its lustre. When managers tackled that from 2003 onwards, they neglected the loss of competitiveness in a European market where rivals were staking out claims to traditional Mercedes territory.

But none of that should obscure the vindication of Mr Schrempp's chief insight. Without Daimler, Chrysler would be in liquidation; and without Chrysler, Mercedes would be confined to a limited future of narrowing horizons, as rivals encroached on the luxury market. Strategic mergers may sometimes be necessary, even if they are mighty hard to pull off.

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China's exchange rate

Gently towards the heavens

Mar 30th 2006
From The Economist print edition

The Chinese yuan has risen by more than you might think

ImagineChina

Get article background

ANYONE who hoped that the yuan would ascend rapidly after China ended its decade-old peg to the dollar last year has been disappointed. Since it was revalued by 2.1% in July, the yuan has crept up by a mere 1% against the dollar. Not surprisingly, the complaints from Washington have been getting louder.

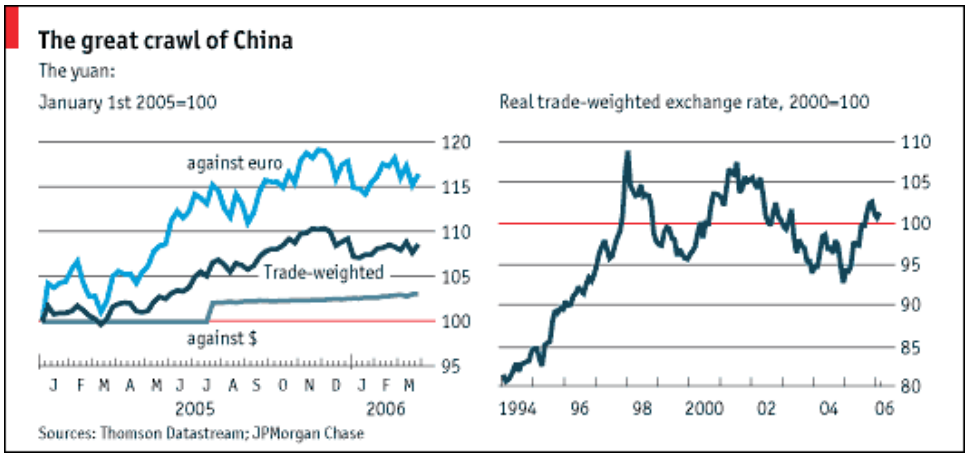
In fact, on a broader basis than simply against the dollar, the Chinese currency has risen by more than is commonly claimed. And even against the greenback, the pace of appreciation has picked up in recent weeks. In the six months after last summer's adjustment, the yuan rose against the dollar at an annual rate of only 1%. But since early February it has been going up at an annual rate of almost 4%. On this trend there could be less than eight yuan to the dollar (compared with the old peg of 8.28) by late April.

This change of pace and a recent visit to Beijing have helped to persuade two American senators, Charles Schumer and Lindsey Graham, to hold back their bill proposing a tariff of 27.5% on Chinese imports unless the yuan was significantly revalued. The Senate had been due to vote on March 31st. As if to goad the two senators, on March 29th, the day after the vote was postponed, the yuan fell by the most in a day since the dollar peg was abandoned. This was largely because of a general rise in the dollar after America's Federal Reserve raised interest rates for its 15th consecutive meeting, to 4.75%, and hinted at further increases.

Political pressure on the yuan is mounting. In April America's Treasury Department is due to issue its semi-annual report on exchange-rate practices, which assesses whether countries manipulate their currencies in order to gain an unfair advantage in international trade. Last November's report had harsh words for China and looked like a final warning. The Treasury has hinted that this time it will declare China a currency manipulator, but its report will probably be delayed until after the visit of President Hu Jintao on April 20th. Once China is branded a cheat, Congress will feel freer to pass protectionist measures against Chinese goods, and the White House will find such measures harder to veto.

On March 28th a milder rival to the Schumer-Graham bill was proposed by Charles Grassley and Max Bancus, the senior men on the Senate Finance Committee. This would have the Treasury determine whether a currency is “fundamentally misaligned” against the dollar, implying a lower standard of proof than “manipulation”. If a currency were found to be misaligned, the government would be required to impose sanctions.

Although Americans are frustrated about its tiny rise against the dollar, on other fronts the yuan has been livelier. Last year it gained 18% against the euro as the dollar itself rose briskly. Its trade-weighted value rose by 10% in 2005, before slipping a bit this year (see left-hand chart, below).



Even though a lot of attention is given to the yuan-dollar rate, the trade-weighted rate has a much greater effect on both China's economy and the world's. The Chinese government was understandably reluctant to allow the yuan to rise much against the dollar while the dollar itself was climbing last year. Indeed, had China truly linked the yuan to a basket of currencies, as it said it would last July, the yuan would have fallen against the strengthening greenback. That it rose at all is a sign that the Chinese bent to political pressure.

Admittedly, last year's rise in the yuan's trade-weighted value followed three years of decline. But on a longer-term view, the currency looks far from cheap. Between 1994 and 2001, its real trade-weighted value (ie, adjusted for inflation differentials) gained 30%, dragged up by a rising dollar. It is still well above its average for the past decade (see right-hand chart, above). Those who accuse the Chinese of pursuing a cheap-yuan policy forget that during the East Asian crisis China did not devalue, although almost all its neighbours did.

The opportunity to fly

Last year the Chinese were unlikely to let the yuan rise by much against a strong dollar, for fear of making their exports much less competitive all round. The converse, though, is that if the dollar falls soon, China will be more willing to allow its currency to rise against America's. Suppose that the Chinese are happy that the yuan's trade-weighted value rises by 5% this year. Capital Economics, a London research firm, calculates that this could mean a rate of 7.60 to the dollar by the end of this year, if the dollar stays where it is against other currencies. But if the dollar falls by 5% this year, the yuan might rise by 10%, to 7.20 to the dollar. A weak dollar will therefore make it easier for China to pacify America and so ward off sanctions.

The 27.5% tariff proposed in the Schumer-Graham bill is the middle of a range, from 15% to 40%, of estimates of the yuan's undervaluation against the dollar that the two senators knew about. However, after reading several gauges, the IMF finds little strong evidence that the yuan is that much undervalued. Estimates by several investment banks suggest that 10-15% is nearer the mark. If that's right, the yuan could be fairly valued within a year if it rose by 10% against the dollar and if wages in China's export industries continue to rise much faster than wages in America.

Another factor that may help to defuse tensions is that China's trade surplus could narrow this year. That surplus surged last year, to $102 billion from $32 billion in 2004, but not because exports boomed. Exports in fact grew more slowly in 2005 than in 2004, but the pace of import growth fell by much more, owing to a sharp slowing of investment and construction after the government acted to stop the economy overheating.

The past few months' figures suggest that imports are rebounding and exports have slowed more sharply. This should help to stabilise the surplus, if not shrink it. According to Jonathan Anderson at UBS, in the fourth quarter of 2005 imports increased in real terms at an annual rate of 25% and exports at only 5%.

While the trade surplus has been levelling off, inflows of speculative foreign capital also seem to have been dwindling. As American interest rates have risen, China's overnight rate has stayed at only 1.6%, discouraging inflows of hot money. This should mean that the People's Bank of China, the central bank, will need to buy fewer American T-bonds to hold down the yuan. Even so, the *China Business Daily*, an official publication, said this week that China's reserves have now overtaken Japan's, rising to $854 billion in February.

China has made clear that it will allow more flexibility in its exchange rate. Since last summer, the Chinese

authorities have carried out several reforms in the foreign-exchange market, introducing forward contracts and swaps, creating an independent market-making system among banks and giving firms more freedom to invest foreign exchange offshore. Indeed, bigger daily movements in the yuan over the past few weeks suggest that the central bank is purposely creating volatility, to encourage firms to hedge their positions and so create a more liquid foreign-exchange market.

In a speech this week Zhou Xiaochuan, the central bank's governor, said that he understood it was in China's interest to make the yuan more flexible over time, but that this needed to be gradual, so foreigners must not push too hard. Are they listening in Washington?

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South-East Asia's exchange rates

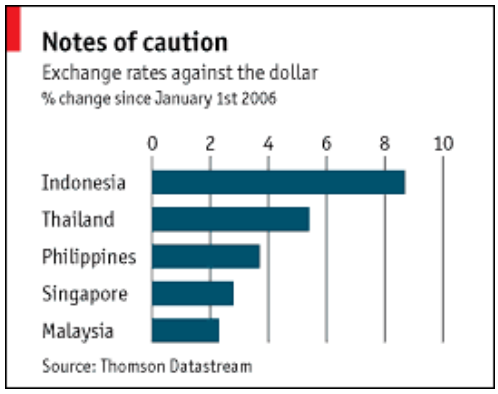
Perky pesos, rallying rupiah

Mar 30th 2006 | BANGKOK AND SINGAPORE
From The Economist print edition

The region's currencies stay strong amid the squalls

WITH political unrest dominating the headlines in Thailand, the Philippines, Indonesia and, unusually, in Malaysia, which has had street protests against fuel-price rises, you might expect South-East Asia's currencies to be drooping. In fact, they have been rather strong (though they wobbled this week after America's Federal Reserve raised its interest rates). Speculation that China might let the yuan rise faster is one reason. Others include inflows of money from rich-country investors seeking high returns; and signs that, despite the political noise, the region's governments are running their finances well, in particular by cutting fuel subsidies.

The gains in the region's main currencies have not been spectacular (see chart) but they are provoking squeals from local businesses. President Gloria Arroyo of the Philippines has said she will try to cut fees charged to exporters, to help them cope with the peso's strength: it is up by almost 4% against the dollar this year. While fending off calls for her impeachment and rounding up alleged coup-plotters, Ms Arroyo's government has also been improving its tax-gathering, while expat Filipinos have been sending home bumper remittances—a record $12.3 billion last year.



The Philippines' central bank says that the peso floats freely and it will intervene only to smooth volatility. However, Thailand's and Malaysia's central banks have been buying dollars to slow the rises in the baht and ringgit. Since Malaysia moved to a “managed float” on the same day as China revalued the yuan last July, the ringgit, like the yuan, has not been allowed to rise too far. But this has only fuelled speculation that Malaysia will follow any further Chinese moves upwards, an expectation that has affected other currencies.

Indonesia's rupiah, which was sliding earlier this year, has bounced back to around its highest since late 2004. Indonesian businesses are pressing the government to stop it going further. While some of its neighbours have been raising interest rates to control inflation and keep pace with the Fed, Indonesia is in easing mode, aiming to boost economic growth. Its bonds yield around 12%, among Asia's highest, giving it room to cut rates without deterring investors. Though the Singapore dollar is close to its highest for seven years, some analysts expect the city-state's central bank to raise the ceiling on the currency's (unpublished) trading band soon, to counter the inflationary effects of high oil prices and a tight labour market.

Up to a point, the firmness of South-East Asia's currencies is helpful: it holds inflation down at a time when the subsidy cuts are causing popular unrest. But you can have too much of a good thing. If currencies become too dear, they could damage the region's export-dependent economies. Masahiro Kawai, an official at the Asian Development Bank, this week urged the region to prepare for a slump in the dollar, the probability of which he compared to that of a global bird-flu epidemic: it is far from a certainty but would have a tremendous impact if it happened.

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Regulating hedge funds

Thorns in the foliage

Mar 30th 2006 | GREENWICH, CONNECTICUT
From The Economist print edition

Financial watchdogs are making life less comfortable for hedge funds

Get article background

LIFE looks pretty good in hedge-fund country. The mansions are sprawling; luxury-car dealerships—Mercedes, BMW, Maserati, Ferrari—sit cheek by jowl; and there are lots of fancy shops and cafés with faux-French names. In Greenwich, home to more than a few investment boutiques, even the local library oozes money: rows of pricey Aeron chairs cushion the posteriors of well-dressed patrons as they browse the internet on flat-screen monitors.

Nevertheless, these days it is becoming harder for hedge-fund managers to make money. Those who invest the wealth of rich individuals, family offices and institutions using fiendishly complicated investment strategies face greater competition. New funds are set up almost every day: across the world there are now more than 8,000. More dollars are pursuing the same strategies, reducing returns for many. The costs of both fund-management talent and office space are climbing.

Since February 1st, new rules have added a layer of cost and compliance for many funds. The Securities and Exchange Commission (SEC) now requires most hedge-fund managers to register if they have 15 American investors or more. The idea is to keep a closer eye on those with lots of investors than on those with a few rich ones, who are presumed to be better able to look after themselves. More than 2,100 hedge-fund managers had registered by the deadline, the SEC says, including many abroad with American clients. Industry lobbying won exemption from the regulation for American (though not foreign) funds with less than $25m under management and investment “lock-up” periods of less than two years.

The new rule, says David Matteson, who heads the hedge-fund practice at Gardner, Carton and Douglas, a law firm, will mean extra costs and a potential “chilling effect on creating new investment strategies.” He is not even convinced that the rule will protect investors. The SEC, he says, lacks the resources to watch over so many funds; and minimum investment requirements in effect bar small investors from hedge funds anyway.

The industry's sheer size—it now manages more than $1.5 trillion, according to HedgeFund Intelligence, a specialised information firm—has prompted regulators around the world to take a much closer look. Recently, the financial regulators in Dublin shut down three hedge funds operated by Broadstone Fund Management, an investment firm. Meanwhile in Britain, where more than three-quarters of Europe's hedge-fund assets are managed, the Financial Services Authority (FSA) has been looking into potential conflicts of interest among fund managers and the unfair treatment of investors.

However, not all the regulatory attention is unwelcome. The FSA has also said that it may allow retail investors, not just institutions or rich individuals, to invest in funds of hedge funds, which spread money across individual funds using a single investment product. Other European countries, including France, Germany and Ireland, have already moved towards regulatory structures that permit retail investment in hedge funds, says Florence Lombard, of the Alternative Investment Management Association, an industry group in London. The European Union has also set up an “expert group” to study harmonisation of member states' rules and taxation on funds.

America's hedge-fund market, though, remains the world's largest and most important. The regulatory tightening there is being watched by hedge-fund managers in other countries too. But they, you suspect, will not be watching as nervously as the good citizens of Greenwich.

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Hedge funds and equity research

Fair comment or foul?

Mar 30th 2006 | NEW YORK
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A hedge fund and a research firm stand accused of manipulating share prices

Get article background

OVER the years hedge funds have been blamed for all sorts of financial mayhem, from sparking the East Asian financial crisis in 1997 to driving up oil prices in 2005. Company bosses often complain that hedge funds are out to ruin them or their business for a quick buck. Biovail, a Canadian drugs firm listed in New York and Toronto, is sure of it. It is suing several funds, an equity-research firm and others for allegedly scheming to drive down its share price.

Biovail's suit, filed in late February, seeks at least $4.6 billion in damages from SAC Capital Management, a $10 billion Connecticut hedge fund, Camelback Research Alliance (now Gradient Analytics), a research firm in Arizona, Bank of America and other defendants. The suit hangs on the claim of five former Gradient employees that in June 2003 Gradient published a negative report on Biovail at the behest of SAC, based on information provided by the hedge fund. They also say that Gradient agreed to delay publication of the report in order to allow SAC to build a big short position in Biovail's shares (ie, a bet that the price would fall). Biovail maintains that this report, research by Bank of America that was allegedly based on it, and an “orchestrated” campaign in the media drove its share price down by more than half by March 2004, making SAC and other short-selling hedge funds “immense ill-gotten profits”.

The defendants vehemently deny the allegations. And there are other explanations of the slump in Biovail's share price: a series of disappointing profit figures, starting in the second quarter of 2003; downgrades by analysts (not only Bank of America's); and inquiries into the company's accounting and financial-disclosure practices by both the Securities and Exchange Commission (SEC) and the Ontario Securities Commission.

Biovail's claim is similar to one already being pursued by Overstock.com, an online retailer which also accuses hedge-fund short-sellers and Gradient of colluding to drive down its share price. (The SEC has sent subpoenas to Gradient as part of an inquiry into possible market manipulation.) Both suits reflect companies' anxiety about the size and power of the hedge-fund industry. While regulators worry about which investors should be allowed to dabble in funds that may prove beyond their means and understanding (see article), company bosses lose sleep over the penchant of many hedge funds for aggressively buying and selling shares. Funds' taste for shorting makes them sweat most of all.

A matter of opinion

But the suits reflect a further worry, about the use (or abuse) of opinion. Hedge funds routinely feed ideas—both “shorts” and “longs”—to each other and tout their views to analysts, journalists and regulators. Some analysts admit that their hedge-fund clients press them to write reports in line with the funds' views. “We have had hedge funds try to twist our arms to write reports a certain way. The pressure definitely exists,” says one. Biovail's suit claims that in just this way SAC persuaded Gradient to publish a “hatchet job” on the drug company and that this amounts to market manipulation.

Proving this will be hard. It does not help that, according to Karen Hinton, Gradient's spokeswoman, the analysts in question were fired for “malfeasance, poor performance or both”. Proving manipulation by short-sellers is “exceedingly difficult”, says John Coffee, of Columbia Law School. Hedge funds are free to air their views, however loudly, as long as they do not say what they know to be false.

Any independent research firm worthy of the name should verify information coming from a hedge fund. But even if it didn't, it is not clear what rules it would break. Unlike Wall Street banks, research firms such as Gradient cater to institutional clients rather than retail customers and are independent of a broker-dealer. Therefore they are not subject to the rules of self-regulatory organisations, such as the New York Stock Exchange and NASDAQ, says Mr Coffee.

Ms Hinton adds that it makes little business sense for independent research houses to publish “biased research”.

Few institutional clients would be willing to pay fees of tens of thousands of dollars for shoddy work. And any reports by firms known to produce skewed research would be discounted by the market—and thus have no impact.

Lynn Turner, a former chief accountant at the SEC, believes that hedge funds and research firms should be punished for intentionally publishing false, negative information “to the full extent of the law”—just as Wall Street analysts were punished for writing false, rosy stuff a few years ago. But Mr Turner cautions against any broader attempts to fight short-sellers. “Ethical short-sellers are good for the financial markets,” says Mr Turner. After all, it was hedge-fund short-sellers who first unearthed financial jiggery-pokery at Enron and elsewhere, and who tipped off America's regulators.

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An Icelandic financial saga

Storm in a hot tub

Mar 30th 2006
From The Economist print edition

A Nordic nation's debt problems are unlikely to spread far beyond its shores

MORE than almost anything, Icelanders like a soak in hot water. Reykjavik has more thermal spas per head than any other city in the world. But lately, the North Atlantic nation has been feeling more heat than it bargained for.

On February 21st Fitch, a rating agency, cut its outlook on Icelandic sovereign debt to negative from stable, drawing attention to a current-account deficit that ballooned to 15% of GDP in 2005 and fast-rising foreign debt. Since then, the krona has tumbled, the government has scrapped a couple of bond auctions because investors wanted too high a yield, and American money-market investors have refused to roll over some short-term debt issued by the country's main banks. On March 30th the central bank raised interest rates by three-quarters of a point, to 11.5%. More increases are surely on the way.

With only 300,000 people and an economy one-third the size of Luxembourg's, Iceland's troubles may sound like the fabled headline, “Small earthquake: not many dead.” But dire warnings of contagion have flourished out of all proportion to the country's size.

At least Icelanders are used to attention. One of the best business stories of recent years has been the raids across Europe by its well educated young entrepreneurs. Armed with cheap debt, they have stormed retailers, banks and drug, food and telecoms companies. Shoulder-to-shoulder with them have been Iceland's three main banks, Kaupthing, Landsbanki and Glitnir (formerly Islandsbanki). Because the pool of domestic deposits is tiny, they have raised money abroad to lend to their voracious borrowers. Last year alone, the banks issued €17 billion ($21 billion) of debt—more than the country's GDP. Not for nothing did Iceland become known as a giant private-equity fund.

Now things are changing. While global interest rates were low, speculators scooped up the banks' paper and the high-yielding krona. As interest rates rose, these investors became less inclined to overlook economic imbalances. Overnight, Iceland became the worst affected of a small group of countries—also including New Zealand—with currencies that had fallen victim to increased risk aversion.

Aspects of Iceland's frothy financial renaissance always warranted caution. Its broad stockmarket index has climbed by 270% in three years. Its banks both lend to their clients and invest in them. Those clients are often shareholders. And according to CreditSights, a bond boutique, banks have €13.6 billion of debt maturing this year alone.

But little Iceland is not Thailand or Turkey. Its largest bank, Kaupthing, is only the 50th biggest in Europe. This week Standard & Poor's, a rating agency, assuaged some fears when it rated Glitnir at a level higher than credit-derivative investors had expected. The banks insist they have ample liquidity. Now all they have to do is prove it.

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About sponsorship

Economics focus

Of angels and banking

Mar 30th 2006
From The Economist print edition

A new book highlights the danger of seeing banking regulators as a pure force for good

THE last time anyone thought to connect angels and banking was in 1946, when James Stewart starred in “It's a Wonderful Life”. Soft-hearted readers will recall that Stewart's character heroically prevents a Depression-era run on his bank, and is dissuaded from suicidal plans brought on by the bank's probable collapse by a guardian angel called Clarence Oddbody.

Sixty years on, three economists, James Barth, Gerard Caprio and Ross Levine, have published a book, called “Rethinking Bank Regulation: Till Angels Govern”*, which analyses the attempts by governments around the world to make the banking system safe from calamities such as the run that nearly did for Stewart's fictitious institution. Alas, the book resists the claim that Clarence Oddbody has been moonlighting at the Federal Reserve, calling himself Alan Greenspan. Instead, it provides controversial criticism of what the authors regard as the other-worldliness of much bank regulation.

The book's title is inspired by the words of James Madison, one of America's founding fathers:

> If men were angels, no government would be necessary. If angels were to govern men, neither external nor internal controls would be necessary. In framing a government which is to be administered by men over men, the great difficulty lies in this: you must first enable the government to control the governed; and in the next place oblige it to control itself.

The difficulty of getting government to control itself is one aspect of what economists call regulatory failure. The central argument of the new book is that although much bank regulation is introduced for the best of reasons—for instance, to tackle market failures such as bank runs—it tends to be written without due consideration for the risk of regulatory failure. As a result, such failure often occurs and frequently has worse consequences than the market failings it is supposed to address.

To reach this conclusion, Messrs Barth, Caprio and Levine have built the first comprehensive global database of bank regulations. This they were able to do by extracting information from normally reticent governments using the clout of the World Bank, where Mr Caprio worked until January. Indeed, conscious that they have only scratched the surface of this data, and keen that it be put to good use, each copy of the book comes with a CD-ROM containing two databases, one from 1998-99, the other from 2003, spanning 150 countries.

The absence, until now, of good data may be one reason why so much bank regulation has been written without a sense of what actually works in practice, reckons Mr Barth, a veteran of bank regulation who recently led an international team that advised the People's Bank of China on banking reform. With their new data, the economists analysed the relationship between different sorts of regulations and indicators of the health of a country's banking system, including the efficiency of its banks, the extent of corruption, how developed the system is and, of course, the likelihood of a crisis.

Pillars of respectability

In particular, they focused on the three broad categories of regulation that are championed in the Basel 2 banking regulations now being urged on the world. The first of these three “pillars” requires banks to set aside a certain amount of capital as a reserve against losses, varying with risk. The second involves stronger supervisory powers to enable government regulators to scrutinise and discipline banks. The third pillar consists of monitoring by markets, and stresses transparency, full disclosure of information and private, dispersed ownership of banks. As well as finding huge differences in banking regulations around the world, which makes them sceptical about the notion that there is an effective “one size fits all” model of banking regulation, the economists drew several striking conclusions.

First, they found that raising capital requirements had no discernible impact on whether a country had a more developed banking sector (measured by the amount of credit extended to private firms as a proportion of GDP), had more efficient banks (measured by net interest rate margins and overheads) or was less likely to experience a

banking crisis.

Second, regulatory policies that boost private-sector monitoring of banks—even in countries with poorly developed capital markets, accounting standards and legal systems—tend to make banking systems more developed, banks more efficient and crises less likely. But the more generous deposit insurance is, the more likely is a banking crisis: however well intentioned, such protection seems to aggravate “moral hazard” by making savers less careful about whom they trust with their money.

Perhaps the most surprising result concerned the supervisory powers of bank regulators. Strengthening supervision had a neutral or negative impact on banking development, reduced bank efficiency and increased the likelihood of a crisis. Why? One clue is a finding that corruption in bank lending tends to be higher in countries with stronger supervisors, except in places with strong legal systems and political institutions. Stronger supervisory powers in countries with weak governance may give bent officials more chance to help themselves. Although some economists question whether stronger supervision really causes these problems, rather than merely coinciding with them, the authors worry that Basel 2's second pillar might do a lot of damage: “The overriding message is that simply strengthening direct official oversight of banks may very well make things worse, not better, in the vast majority of countries.” Where's Clarence Oddbody when you need him?

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About sponsorship

Treating AIDS

1.3 by 5

Mar 30th 2006
From The Economist print edition

The World Health Organisation's attempt to roll out AIDS drugs in poor countries has missed its target. A shame, but not a disaster

Get article background

AN OPTIMIST, so the old saying has it, sees a glass that is half-full, while a pessimist sees one that is half-empty. And that is probably a good light in which to view the announcement that the “3 by 5” initiative to get 3m HIV-positive people in poor and middle-income countries on to anti-retroviral drugs by the end of 2005 has got rather less than halfway there. According to a report on the initiative, just published by its sponsors, the World Health Organisation (WHO) and UNAIDS, a mere 1.3m of those infected in the target countries are on courses of the drugs.

The “3 by 5” initiative, announced in December 2003, marked the culmination of a change in thinking about how to tackle the global AIDS epidemic that had begun at the international AIDS conference in Durban, in 2000. Until the Durban conference, the general line among experts on the epidemic was that prevention was more important than treatment. That was partly because their focus was on trying to stop the disease spreading, and partly because the drugs required to treat those already infected were too expensive for widespread deployment in poor countries—particularly the very poor ones in Africa where AIDS bites deepest.

The shift in thinking came about because of the protests of those infected—or, rather, of their activist representatives—and also because of a realisation that without the incentive of treatment, those who might or might not be infected had little reason to find out the truth. Such ignorance was undoubtedly helping to spread the virus, whereas if people came forward for testing and treatment, they could, in addition, be encouraged to modify their behaviour to reduce the likelihood that they would transmit the disease.

3 by when?

The disinterested observer's reaction to the report is probably best summed up by the first rule of economic forecasting, “give 'em a number or a date, but not both”. The eponymous goal of the initiative was not quite plucked out of the air, but it was, in retrospect, absurdly optimistic. It was derived from a paper published in *Science*, in 2001, which attempted to quantify the need for treatment, and the amount of money that could usefully be spent on it. This paper estimated that 6m people were suffering from symptoms so advanced that their lives were in danger, and hazarded that it might be possible to treat half of them with anti-retroviral drugs, and thus save their lives.

Since only 400,000 people were being treated when the initiative began, that number would have to have been multiplied almost eightfold in two years. But even a three-plus-fold multiplication is not a negligible improvement. As Kevin De Cock, the newly appointed head of AIDS at the WHO, points out, this averted about 250,000 premature deaths in 2005.

One of the main problems turned out to be that in most countries the infrastructure to achieve a large-scale roll-out of anti-HIV drugs did not exist. Indeed, it is noticeable that much of the initial benefit has been captured by places that already had good health infrastructures.

In this context, though, the initiative may have been more successful than the headline figure suggests, since part of the money has gone on infrastructure. That means building clinics and testing laboratories, but also training doctors (surprisingly many of whom, more than two decades after AIDS was identified, have still not been taught how to deal with it) and reorganising hospital administrations. This sort of work has spin-offs beyond the treatment of AIDS.

Some of the money to do all this has come from the afflicted countries themselves. Much of the rest has been disbursed through three conduits from the rich to the poor worlds: the Global Fund to Fight AIDS, Tuberculosis and Malaria, based in Geneva; the President's Emergency Plan for AIDS Relief (the president in question being George Bush); and the World Bank. (The WHO and UNAIDS have acted as cheerleaders and advisers, rather than dispensers of largesse.)

The expense of treatment has also been tackled. For the other big change that has come about as a result of the initiative is in the market for AIDS drugs.

Here, a former American president with time on his hands and an urge to do good works has helped things along. The Clinton Foundation HIV/AIDS Initiative has helped to defragment the market for generic anti-retroviral drugs (those no longer in patent) by signing contracts with manufacturers in India and South Africa that guarantee large order-volumes and reliable payment. As a result of this and similar initiatives, the price of a course of these drugs has, in some cases, fallen below $150 per person per year—down from over $1,000 at the turn of the century.

Progress, then, is being made. And perhaps the most telling sign of that is what has not happened. The AIDS-activists' organisations, normally sensitive to the least failure to honour a pledge, have, by and large, kept quiet. Dr De Cock will not be drawn into predictions about what progress to expect over the next few years, but Mr Clinton (admittedly not an epidemiologist) says he will be both disappointed and surprised if the 3m figure is not reached by the end of this year. With an epidemic the size of AIDS, that means a lot of extra deaths. But, realistically, it is not that great an overrun.

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Imaging technology

A discerning view

Mar 30th 2006
From The Economist print edition

A new way of processing X-rays gives much clearer images

Before and after

X-RAYS are the mysterious phenomenon for which Wilhelm Röntgen was awarded the first Nobel prize in physics, in 1901. Since then, they have shed their mystery and found widespread use in medicine and industry, where they are used to reveal the inner properties of solid bodies.

Some properties, however, are more easily discerned than others. Conventional X-ray imaging relies on the fact that different materials absorb the radiation to different degrees. In a medical context, for example, bones absorb X-rays readily, and so show up white on an X-radiograph, which is a photographic negative. But X-rays are less good at discriminating between different forms of soft tissue, such as muscles, tendons, fat and blood vessels. That, however, could soon change. For Franz Pfeiffer of the Paul Scherrer Institute in Villigen, Switzerland, and his colleagues report, in the April edition of *Nature Physics*, that they have manipulated standard X-ray imaging techniques to show many more details of the inner body.

The trick needed to discern this fine detail, according to Dr Pfeiffer, is a simple one. The researchers took advantage not only of how tissues absorb X-rays but also of how much they slow their passage. This slowing can be seen as changes in the phase of the radiation that emerges—in other words of the relative positions of the peaks and troughs of the waves of which X-rays are composed.

Subtle changes in phase are easily picked up, so doctors can detect even small variations in the composition of the tissue under investigation, such as might be caused by the early stages of breast cancer. Indeed, this trick—known as phase-contrast imaging—is already used routinely in optical microscopy and transmission electron microscopy. Until now, however, no one had thought to use it for medical X-radiography.

To perform their trick, the researchers used a series of three devices called transmission gratings. They placed one between the source of the X-rays and the body under examination, and two between the body and the X-ray detector that forms the image. The first grating gathers information on the phases of the X-rays passing through it. The second and third work together to produce the detailed phase-contrasted image. The approach generates two separate images—the classic X-ray image and the phase-contrasted image—which can then be combined to produce a high-resolution picture.

The researchers tested their technique on a Cardinal tetra, a tiny iridescent fish commonly found in fish tanks and aquariums. The conventional X-ray image showed the bones and the gut of the fish, while the phase-contrasted image showed details of the fins, the ear and the eye.

Dr Pfeiffer's technique would thus appear to offer a way to get much greater detail for the same amount of radiation exposure. Moreover, since it uses standard hospital equipment, it should be easy to introduce into medical practice. X-rays may no longer be the stuff of Nobel prizes, but their usefulness may just have increased significantly.

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Encyclopedias

Battle of Britannica

Mar 30th 2006
From The Economist print edition

War has broken out between Encyclopædia Britannica and Nature

AT FIRST, it was an innocuous test of accuracy. Last year, journalists at *Nature* wondered how scientific entries in Wikipedia—a free web encyclopedia that anyone can edit—compared with those in "Encyclopædia Britannica". They compiled a list of subjects, downloaded relevant entries from each website, and sent the results to experts.

The findings were published in December and Britannica won—a blow had been struck by the gold-standard encyclopedia compiled by experts over the collective knowledge of a bunch of hobbyists and amateurs. Except that the results held a surprise. Britannica contained a lot of errors, and it was only 30% more accurate than the free encyclopedia.

This was all too much for Britannica. So, five weeks ago, it launched a 30-strong team of rebuttal editors and experts to pick apart the *Nature* study. The team's 20-page report concluded that "almost everything about the journal's investigation was wrong and misleading". Oh, and it demanded that *Nature* retract its study. *Nature* hit back with its own rebuttal and refused to retract anything. On March 27th Britannica fired another salvo, with advertisements in the *Times* and the *New York Times*. *Nature* returned fire with a rebuttal editorial.

Some of Britannica's criticisms are quibbles. It didn't like *Nature*'s headline, and Ted Pappas, Britannica's executive editor, says *Nature* didn't allow Britannica to see any of the evidence on which the study was based until a week after it was published. That was a bit unsporting. In the media binge after the study's release, *Nature*'s journalists talked widely about their findings, while Britannica's editors felt they could not defend themselves.

Besides these quibbles, there are a couple of more serious issues. One is the overall accuracy of Britannica, the other is its relative accuracy compared with Wikipedia. On the first, *Nature* identified 123 errors in 42 Britannica articles. These comprise factual errors, misleading statements and critical omissions.

However, many of these "errors" are really the opinion of the reviewers. For example, a *Nature* reviewer says of the Britannica entry on the Cambrian period that the "evolution of hard parts at the beginning of the Cambrian involved much more than development of calcium carbonate." Britannica replies: "the article does not claim or imply that calcium carbonate explains all there is to know about hard parts." In total, Britannica contests 58 "errors"—all points on which a legitimate debate might be had. This is important. If these are not mistakes, then Britannica has 1.5 errors in each article, not three.

Nature's response has been to argue (correctly) that the point of the study was to compare encyclopedias. Because reviewers were not told which article was from which encyclopedia, there would be no systematic bias one way or another. They would be just as likely to have differences of opinion with Wikipedia.

Nevertheless, there are some concerns about the study. For a start, one has to wonder how reviewers could fairly compare the misleading statements in Britannica's largely well written and edited articles with those in Wikipedia's sometimes poorly written and edited articles. Comments like, "this is a badly written article" were not counted.

Ignoring this unknown, there are two potential sources of bias. One is in errors of omission. Of Britannica's 58 debatable errors, about 20 are omissions. But Wikipedia articles are longer than Britannica's and have a tendency to accumulate material and facts—gathering all that is known on a subject. Britannica, by contrast, edits its subjects for style and readability. This means leaving things out for clarity. Any side-by-side comparison is therefore likely to notice more omissions in Britannica, because fewer facts have been included. That does not necessarily make Britannica less accurate. And if all the 20 omissions in Britannica were unfair, Wikipedia would actually be 50% less accurate not 30%.

The other concern is in the way the data were compiled. *Nature*'s journalists were not always able to find identical subject entries in both encyclopedias. When that happened, they did an online search on the subject at both websites and, if necessary, bolted together bits from several articles. (Britannica complains that in some cases they used paragraphs from a children's encyclopedia.)

Yet this compilation was not being done blind. So when *Nature*'s journalists compiled the material, they could have

introduced an unconscious but systematic bias. Also, because Wikipedia has 1m entries and Britannica has only 124,000, it is possible that reviewers were more often sent complete Wikipedia articles to compare with cobbled-together Britannica articles than the other way round.

It is difficult to avoid concluding that the *Nature* study was comparing apples with oranges. In any case, most people don't need an expert to tell them that, while Britannica is readable and reliable, Wikipedia is a fantastically useful source of rough and ready information. And, on top of that, it's free.

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Biotechnology

Here be dragons

Mar 30th 2006 | SAN MELITO
From The Economist print edition

With luck, you may soon be able to buy a mythological pet

PAOLO FRIL, chairman and chief scientific officer of GeneDupe, based in San Melito, California, is a man with a dream. That dream is a dragon in every home.

GeneDupe's business is biotech pets. Not for Dr Fril, though, the mundane cloning of dead moggies and pooches. He plans a range of entirely new animals—or, rather, of really quite old animals, with the twist that even when they did exist, it was only in the imagination.

Making a mythical creature real is not easy. But GeneDupe's team of biologists and computer scientists reckon they are equal to the task. Their secret is a new field, which they call “virtual cell biology”.

Biology and computing have a lot in common, since both are about processing information—in one case electronic; in the other, biochemical. Virtual cell biology aspires to make a software model of a cell that is accurate in every biochemical detail. That is possible because all animal cells use the same parts list—mitochondria for energy processing, the endoplasmic reticulum for making proteins, Golgi body for protein assembly, and so on.

Armed with their virtual cell, GeneDupe's scientists can customise the result so that it belongs to a particular species, by loading it with a virtual copy of that animal's genome. Then, if the cell is also loaded with the right virtual molecules, it will behave like a fertilised egg, and start dividing and developing—first into an embryo, and ultimately into an adult.

Because this “growth” is going on in a computer, it happens fast. Passing from egg to adult in one of GeneDupe's enormous Mythmaker computers takes less than a minute. And it is here that Charles Darwin gets a look in. With such a short generation time, GeneDupe's scientists can add a little evolution to their products.

Each computer starts with a search image (dragon, unicorn, gryphon, etc), and the genome of the real animal most closely resembling it (a lizard for the dragon, a horse for the unicorn and, most taxingly, the spliced genomes of a lion and an eagle for the gryphon). The virtual genomes of these real animals are then tweaked by random electronic mutations. When they have matured, the virtual adults most closely resembling the targets are picked and cross-bred, while the others are culled.

Allstar

Generation 1.0

Using this rapid evolutionary process, GeneDupe's scientists have arrived at genomes for a range of mythological creatures—in a computer, at least. The next stage, on which they are just embarking, is to do it for real.

This involves synthesising, with actual DNA, the genetic material that the computer models predict will produce the mythical creatures. The synthetic DNA is then inserted into a cell that has had its natural nucleus removed. The result, Dr Fril and his commercial backers hope, will be a real live dragon, unicorn or what have you.

Readers with long memories may recall GeneDupe's previous attempt to break into the pet market, the Real Goldfish (see article). This animal was genetically engineered to deposit gold in its skin cells, for that truly million-dollar look. Unfortunately Dr Fril, a biologist, neglected to think about the physics involved. The fish, weighed down by one of the heaviest metals in existence, sank like a stone, as did the project. He is more confident about his new idea, though. Indeed, if he can get the dragons' respiration correct, he thinks they will set the world on fire.

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About sponsorship

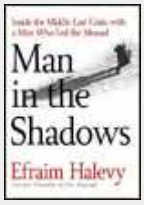
Mossad

A spymaster's story

Mar 30th 2006
From The Economist print edition

The intrigues behind Israel's diplomacy, and sometimes America's too

Man in the Shadows: Inside the Middle East Crisis with a Man Who Led the Mossad
By Efraim Halevy



St Martin's Press; 304 pages; $24.95. Weidenfeld & Nicolson; £18.99

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TOP spymasters usually take a while to emerge from the shadows. Efraim Halevy has waited only four years. As director of Israel's Mossad intelligence service until 2002, and one of its senior executives for 33 years, he must possess a Scheherezade's store of tales. Needless to say, few real secrets have made it into this book. Readers expecting insights into tradecraft, assassinations, dead-letter drops and secret codes will be disappointed. Even so, by filtering familiar events through the unfamiliar lens of the spymaster, Mr Halevy gives a fresh twist to the story of the period he focuses on: the 13 years between Saddam Hussein's invasion of Kuwait in 1990 and the American invasion of Iraq in 2003.

The possession of secrets lifts a spy's life above the ordinary. Yet some modern spymasters do more than merely try to understand the world, they try also to change it. Since Israel has so little formal contact with its neighbours, it falls to its military and intelligence officers, says Mr Halevy, to conduct the “most meaningful contacts and negotiations” with its adversaries.

Two examples of Mossad-led diplomacy stand out in this book. One is its central role in shaping relations with

Jordan. On the eve of the 1991 Gulf war, Mossad used its ties with the late King Hussein to work out what to do if Saddam Hussein fired missiles at Israel. Mr Halevy set up a secret meeting between the king and Yitzhak Shamir, Israel's prime minister of the time. There was no meeting of minds, but there was, says Mr Halevy, “a meeting of hearts”, and the king came to like and admire the stubborn former Mossadnik.

Then in 1994, as Mossad's deputy head, Mr Halevy helped to rescue the king from the isolation Jordan had earned during that war by siding with Iraq against the American-led coalition. At a routine meeting in Amman, the conversation took a dramatic turn; the king seemed at last to be willing to enter into a formal strategic agreement with Israel. With the support of Yitzhak Rabin, Mr Halevy choreographed the secret diplomacy that culminated in a formal peace agreement.

Three years later, as Israel's ambassador to the European Union, Mr Halevy was called upon to make a third fateful intervention in Jordan. Mossad had tried to assassinate Khaled Mashal, a Hamas leader, in Amman by squirting a slow-acting poison in his ear. The attempt was bungled, two agents had been captured by the Jordanians and another four were holed up in the Israeli embassy. With his precious peace treaty at risk, Mr Halevy was summoned home to save the situation. This he did by engineering a swap: in return for forgiveness (and the six Israeli agents), Israel released the jailed founder-leader of Hamas, Sheikh Ahmed Yassin (only to assassinate him in turn, at the height of the Palestinian *intifada* in 2004).

After this, Mr Halevy was called back to become the agency's head in 1998. Two years later, Mossad was shaping Israel's relations with the Arabs once again.

This time it was the Palestinians. In 2000, Bill Clinton's attempts to broker a peace deal at Camp David failed. The incoming administration of George Bush had no strong interest in this conflict (and even fewer ideas) about what to do. But the Mossad chief began to pick up an unusual message from his friends in Washington. They wanted Israel under Ariel Sharon to come up with a policy that Israel and America could pursue jointly, provided the Israeli ideas did not serve Israel's interests alone, but also America's.

In 2002 a spate of Palestinian suicide-bombings prompted Israel to reconquer the West Bank. But the Israelis had no clear notion of what to do next. So Mossad stepped into the vacuum and produced one: “regime change” for the Palestinian Authority. The spies drafted a plan under which Yasser Arafat would be marginalised and a Palestinian prime minister would take over his executive power. This was intended to produce a credible Palestinian partner for Israel, who might go on to rule a Palestinian state in provisional borders.

Mr Halevy took this plan to foreign capitals where it was received with enthusiasm. It paved the way for the policy-changing speech of June 2002 in which Mr Bush called for the Palestinians to give up on Arafat. *The Economist* said at the time that the speech could have been written by Mr Sharon. It seems that its main ideas were indeed invented by Mossad. The worldwide acceptance of Israel's argument that Arafat's leadership had failed—and the enlistment of the Americans, Europeans, Russians, Egypt and even Saudi Arabia in attempts to circumvent him—was an Israeli intelligence coup of the first order.

Not everything went his way

These examples of Mossad leading diplomacy will be grist to the mill of those who believe in the diabolical manipulative powers of Israel's intelligence services. But Mr Halevy's memoir contains counter-examples aplenty. Mossad, he says, was kept out of the loop on the secret negotiations with the Palestinians in Oslo. Nor are the Americans often Israel's patsies. Mr Halevy grumbles that his careful work on the Palestinian front was undone when, in order to help Tony Blair as the invasion of Iraq approached, Mr Bush forced Israel to sign the “road map”, which, says Mr Halevy, will eventually become “a formula for a solution that would be imposed with the barrel of an American shotgun.”

As for September 11th 2001, Mr Halevy admits that Mossad, like other intelligence services, was utterly surprised: he felt caught “in a feeling of almost total helplessness”. But he remembers saying that since the Middle East war had penetrated the American continent, the United States was now at war in the Middle East. And since it could not win the war on its own soil, it would sooner or later come to the Middle East in order to do so.

The British-born Mr Halevy is a soft-spoken man with the manners of an Oxford don such as his late uncle Sir Isaiah Berlin. Nonetheless, as befits an Israeli spymaster, he has a hawkish attitude to the war on terrorism, which he characterises as a third world war. He argues that Western governments should exploit the short period of shock that follows terrorist outrages to ram through the draconian policies the public refuses to accept in between attacks. But his thinking has its subtleties. One surprise is that he does not rule out making a tactical alliance with Hamas in Palestine and Hizbullah in Lebanon in order to isolate al-Qaeda. “We will be obliged to sup with the devil, but we must beware at all times that he does not poison our chalice.” Mr Halevy has plainly had a lot of interesting suppers.

Man in the Shadows: Inside the Middle East Crisis with a Man Who Led the Mossad.
By Efraim Halevy.

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About sponsorship

Development aid

In praise of small things

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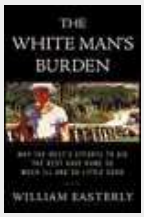
MILTON FRIEDMAN, a Nobel prizewinning economist, once noted the irony of trying to save poor countries from communism by giving them money. “The proponents of foreign aid”, he wrote, “have unwittingly adopted a basic premise of the communist ideology that foreign aid is intended to combat.” Donors, like their communist antagonists, were planners at heart who thought that prosperity could be accomplished by design. For William Easterly, an economist at New York University and author of an ambitious new book that is already causing waves, the aid industry remains a refuge for utopian social engineers whose boldness of vision is matched only by the poverty of their achievements.

Mr Easterly's argument has already had a number of dress rehearsals, including his first book, “The Elusive Quest for Growth”, and a fiery exchange in the *Washington Post* with Jeffrey Sachs, a bold visionary at Columbia University's Earth Institute. Mr Sachs was picked by the United Nations almost five years ago to head a team of over 250 experts, which identified 449 aid interventions in pursuit of eight Millennium Development Goals. Mr Easterly thinks that this approach to helping the poor is seductive but dangerously wrong-headed.

Visionaries, such as Mr Sachs, want to abolish poverty. With that as their goal, they then ask “what does the end of poverty require of foreign aid?” But this is to put the question backwards, insists Mr Easterly. The right question is “What can foreign aid do for the poor?” It is fine, he says, to aim to win the Kentucky Derby if you own a racehorse. But the aid industry is not a thoroughbred. It is more like a milk cow. Poverty campaigners should ask themselves what this set of bovine agencies and institutions can actually accomplish, and see that it gets done.

The White Man's Burden: Why the West's Efforts to Aid the Rest Have Done So Much Ill and So Little Good
By William Easterly



Penguin Press; 417 pages; $27.95

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Compassion is not enough to guide these efforts, Mr Easterly says. Donors must also be answerable to the people they claim to help. The Samaritan should not cross the road unless the injured traveller by the wayside can hold him to account for dressing his wounds and providing a roof for the night. Otherwise donors offer what they want to give, not what the poor can use, and they have little incentive to follow through on any charitable gesture they might make.

The market provides Mr Easterly's ideal of feedback and accountability. Profit-seeking companies learn quickly whether people like what they are offering, otherwise they go out of business. Mr Easterly shares every economist's awe of a system that can deliver 9m copies of Harry Potter's latest adventure to British and American readers on its first day of publication. But, as he admits, this model serves more as an inspiration than as a solution. If markets could serve the poor well, they would be doing so. And many of the things donors and ministries are left to do can be done only clumsily. The market gets books to readers; it is governments who have the harder task of teaching kids to read.

Though he is a free-market fan, Mr Easterly is sceptical of sweeping free-market reforms. He distrusts all attempts at social engineering, even those designed to undo past experiments in planning. He is a tinkerer not an engineer; his favourite word of praise is “piecemeal”.

He puts more faith in organisations with names such as the “Association of Former Women Fuelwood Carriers”—homespun organisations, set up by insiders, in response to a concrete need—than in organisations with names like the Millennium Project or the World Economic Forum, run by outsiders in pursuit of cosmic ambitions. He thinks donors should do one thing at a time, confining themselves to small trials and hence small errors.

This is fine as far as it goes. But perhaps his praise for small things is itself too sweeping. Some things must be done on a large scale if they are to work at all—efforts to stamp out disease often fail if vaccine-coverage is too piecemeal. Some things work only if done together: you can provide textbooks to poor schools and motivate teachers, but children will not learn if they are hungry or discomfited by worms.

Gradualism has its place, but Mr Sachs made his reputation by showing that Bolivia could and should tackle its hyperinflation at a stroke. Mr Easterly thinks Mr Sachs has been spoilt by this early success and now thinks that every problem is amenable to bold strokes. But Mr Easterly is in danger of making the equal and opposite mistake of believing that only doodling can work.

Mr Easterly admits to feeling some compunctions about rubbishing a world in which he himself has spent much of his career, but it doesn't show. He is merciless and witty, damning the aid industry with its own words by quoting its past, broken promises back to it. His book is written more in wry bemusement than in anger, but perhaps anger is the more appropriate response. Certainly this reviewer felt a rising sense of frustration at the aid institutions, encamped on the high moral ground, with their eyes fixed on a distant horizon, all as an escape from taking a long hard look at themselves.

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About sponsorship

Kenya discovers its art

African treasures

Mar 30th 2006 | NAIROBI
From The Economist print edition

Loans from the British Museum have helped create an unusual exhibition

A Tanzanian girl's initiation skirt before it found its way to the British Museum

FEW tourists come to Kenya for the culture. Masai warriors might be titillating over sundowners, but the real interest is lions on the grasslands and snorkelling on the coast. When it comes to culture, the country seems to have little to offer—at least compared with west Africa's cornucopia of art and music.

But, with rapid urbanisation and a rising middle class, Kenyans are beginning to develop something of an underground art culture. In Nairobi that means studios for painters and sculptors, a modern dance company, a literary journal and a hip-hop scene. Not much for a nation of 33.5m people perhaps, but a welcome turnaround for a country whose elite has tended to find its aesthetic in the walnut panelling of its Mercedes-Benz saloons.

The cultural bedrock of Kenya is its national museum system, a series of decrepit though well-visited museums (at least by schoolchildren), with one of the better collections in Africa. With the main Nairobi museum closed for renovation until 2008, the Hazina (which means “treasure” in Kiswahili) exhibition has been shoe-horned into a colonial bungalow in the city's polluted and crime-ridden downtown. But it is still worth the visit. The show is a collaboration with the British Museum, which has lent 140 of the 160 exhibits, as well as experts to help set it up.

Several pieces stand out. One, at the entrance, is a two-metre-long siwa, a ceremonial horn dating from 1688, and belonging to Kenya's own collection. Carved from a single elephant tusk and inlaid with inscriptions in a corrupted Mameluke dialect, the siwa underlines the one-time swagger of the Swahili trading culture and Egypt's influence on it. Another highlight is a late 19th-century rainmaker's skirt from Uganda, acquired by the British Museum in 1902. A prolonged drought in the region gives the charms, chains and small knives hung from the belt a poignant feel.

Inevitably, the presence of so many objects from London has led some Kenyans to call for the repatriation of other treasures in the British Museum. Kiprop Lagat, one of the curators of Hazina, dismisses such talk. “As long as these pieces are in circulation between museums,” he says, “they are universal cultural property.”

Of more lasting influence is a new art installation in the Ngong Forest Sanctuary, a wildlife reserve south of the city. Works by Kenyan and international artists, brought together by the local Kuona Trust and underwritten by the Ford Foundation, explore the potential of the wild forest. Artists have restricted themselves to wood, twine and rock, so that slowly their works will rot back into the forest—or surprise future hikers, as well as the poachers who come from the slums to hack down trees.

Some installations are carved into the rock of dry stream beds, Nubian style, or in one case depicting a giant python that used to slither thereabouts. Others have been woven into webs between trees to catch sunlight or leaves. Logs and twigs form a shrine under an eagle's nest. Canvases of bark are set with a palette of leaves. The forest is a dangerous place. Artists have several armed guards to watch over them, as do visitors who venture there. But, for once, it puts Kenya on the cutting edge of African art.

“Hazina: Traditions, Trade and Transitions in Eastern Africa” is at the Old Provincial Commissioner's House, Kenyatta Avenue, Nairobi, until September 30th.

Ngong Forest Sanctuary Installation is at Ngong Forest Sanctuary, between Kibera and Karen, until it biodegrades.

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Shakespeare

Where there's a Will

Mar 30th 2006
From The Economist print edition

Let the rollicking begin

Will & Me: How Shakespeare Took Over My Life
By Dominic Dromgoole

Penguin/Allen Lane; 304 pages; £17.99

Buy it at Amazon.co.uk

DOMINIC DROMGOOLE, the new artistic director of Shakespeare's Globe theatre in London, has written a passionate, often very funny account of his life so far—a life so thickly signposted by William Shakespeare that the lines between them sometimes blur. The shape of it feels familiar: country boy comes to London, acts, directs, tours, gets drunk, mingles with humanity (young, old, aristocrats, royalty and politicians), and along the way touches both rapture and despair.

Mr Dromgoole raises two fingers to academia, the heritage industry and the genteel tendencies of the Royal Shakespeare Company. His Shakespeare was a bloke who “liked a glass or twelve” and “fancied enormous helpings of extra nookie”. He was a “blind”, instinctive, unconceptual genius who just wrote stories with characters in—“daft chaps in tunics yabbering on and charging about biffing each other.” This is not exactly a quote, but it's close. Mr Dromgoole likes to use a schoolboy lingo, designed to take the reader back to innocent times before Shakespeare was hijacked by the “bootboys” of cultural materialism and the “over-analytical nincompoops hellbent on stuffing weird intentions into the plays.”

But that is not the whole story. In fact, Mr Dromgoole is also an informed, sensitive and thoughtful critic. He can teach you to listen to the stage directions hidden in the very sound and fall of the verse. He can take you through a speech of Hamlet's or Juliet's, and show you how the characters think and feel in the moment, on the hoof. He can swoop effortlessly from low to high: “This glorious, scabby, decrepit old couple,” he says of Antony and Cleopatra, “both raddled by time and fights and fucks, keep raising the odds against themselves and keep pulling it off, coming out smelling of myth and eternity.”

High and low is the point that he is making about Shakespeare. There is room for everyone at the party: “drunks, senators, true believers, nihilists, uncle tom bollocks and all.” Shakespeare grew them, he says, in all their “separate, individual, aliveness” and “then his creative magic was generous enough to set them free on the stage as real humans.”

Mr Dromgoole knows he will sound old-fashioned, and he doesn't care. He is playing for higher stakes. His criticism is a kind of credo for the modern world. Shakespeare's plays reflect humanity in its totality, and with all its messiness and inconsistency. Freedom and democracy, however flawed, are its oxygen. It is the search for coherence in the plays that suffocates them. It belongs with the bigots and the fundamentalists. As Mr Dromgoole puts it: “every time we meet a fundamentalist of whatever hue, we should spit in their eye. For Shakespeare.”

Will & Me: How Shakespeare Took Over My Life.
By Dominic Dromgoole.
Penguin/Allen Lane; 304 pages; £17.99

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Music

Like pearls falling into a jade plate

Mar 30th 2006
From The Economist print edition

New music for a traditional Chinese instrument

Liu Junqi

Lyrical, twangy or how she wants

WHEN Wu Man arrived in New Haven, Connecticut, from Beijing in 1990 she spoke no English and gambled on surviving with the help of her pipa, a traditional lute-like Chinese instrument. She has succeeded triumphantly, working her way from New York's Chinatown to Carnegie Hall, where she gives her debut recital on April 6th.

The pipa is a sonorous, four-stringed, pear-shaped instrument held upright on the lap. Its strings used to be silk but are now steel, which resonates better. The fake fingernails on Ms Wu's right hand pluck the strings, while her left hand fingers the frets. She produces an astonishing range of colours and moods from a 2,000-year-old instrument which produces a sound, observed a poet from the Tang dynasty, like “pearls falling into a jade plate”.

Ms Wu is a virtuoso interpreter of traditional music, creating hauntingly exotic waves of sound with pizzicatos and tremolos (the plucking of one string with all five fingers consecutively). But evocations of dropping pearls soon fade to Jimi Hendrix. During her time in America, Ms Wu has daringly expanded the pipa's range, playing jazz, bluegrass and Bollywood with eclectic instrumentalists—and inspiring numerous works from prominent composers.

The pipa can sound gently lyrical or aggressively modern, which is why, says Ms Wu, it attracts such composers as Terry Riley, Philip Glass, Tan Dun and Bright Sheng, all of whom have written for her. She was the first to partner the pipa with an endongo (an eight-stringed Ugandan instrument), an Appalachian banjo and a string quartet. She was also, she says, the first to play jazz on the pipa.

All this happened after she arrived in America. Young Chinese musicians are now ubiquitous in American and European conservatories, competitions and concert halls, but during China's cultural revolution the performance of Western music was greatly restricted. Traditional instruments, however, were encouraged, and Ms Wu, born in 1964 in Hangzhou, began studying the pipa when she was nine.

She entered the Beijing Central Conservatory of Music (where she heard Western music for the first time) and became the first recipient of a masters degree in the pipa. She was awarded a tenured faculty position. But her curiosity about the West proved irresistible. Colleagues who had emigrated to the United States warned her that there was no interest in Chinese traditional music, but, undaunted, she packed seven instruments (including pipas, a zither and a dulcimer) and set off.

During the first two difficult years she learnt English and cried a lot. She joined other Chinese musicians and began performing in New York's Chinatown, rehearsing in the basement of a dry-cleaner. American musicians would approach her after concerts, fascinated. David Harrington of the Kronos Quartet said that the first time he heard her play was like the first time he heard Jascha Heifetz, a master violinist.

Mr Harrington chose her to perform in the quartet's recent Bollywood-inspired recording because he wanted one person to create many different sounds. Ms Wu, with her “large sonic vocabulary”, was uniquely qualified. She also attracted the attention of Yo Yo Ma, a cellist with whom she now frequently performs as a member of his Silk Road Ensemble.

Pipa players and audiences in China are also becoming more open minded; she caused excitement when she performed in Beijing with the Kronos Quartet ten years ago. “That's my hope,” she says, “that the next generation know there is another way for traditional instruments to survive.”

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Caspar Weinberger

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Getty Images

Caspar Weinberger, an American defence secretary, died on March 28th, aged 88

WHEN the United States invaded Iraq in 2003, it sent one serviceman for roughly every 100 Iraqis. Twenty years earlier, when it had invaded Grenada, it sent one for every 15 inhabitants of that bemused little island. In 1983, though, the secretary of defence had been Caspar Weinberger, who hated risking American servicemen's lives. In 2003, it was Donald Rumsfeld, who believed that, no matter what the generals said, America's troops could sweep to victory if they were fast and few. He longed for the chance to show it, and relished it when he got it.

Mr Weinberger was not exactly a softie. In various government jobs in Washington in the 1970s, his zeal for cutting costs had earned him the nickname “Cap the knife”. But when Ronald Reagan put him in charge of the Pentagon in the 1980s, his deep suspicion of the Soviet Union, and his firm conviction that America needed the military force to intimidate it, led him to preside over a huge expansion of defence spending. If that meant paying $600 for a lavatory seat or $5,000 for a coffee pot, too bad. He liked the service chiefs, and they liked him.

In other respects, too, Mr Weinberger's career serves as a reminder of how the times have changed, while staying the same, over the past two decades. Then, as now, America had a Republican president who saw the world in terms of good and evil, spoke—or misspoke—his mind, and showed little love for the verities of the east-coast establishment. Then, as now, Europeans worried that the United States might be turning away from the old world. And as defence secretary Mr Weinberger, a lawyer from San Francisco who had spent the 1950s and 1960s immersed in Californian politics, did indeed look west across the Pacific and do his best to improve America's relations with Japan and China.

Caspar and the Reaganauts

Yet in many ways Mr Weinberger, a stalwart though he was of the Bohemian Grove, where the revolutionary Reaganauts gathered by California's Russian river each July for male bonding, was a politician of the old school. Educated at Harvard—both the college and the law school—he had volunteered for the army in 1941 and ended the war on the staff of General Douglas MacArthur. (His wartime experience may explain why he, like other old soldiers, was always so reluctant to resort to force.) Moreover, his intellectual interests—history and the law—both drew him to Europe, and Britain in particular.

Fortunately for the British, his Anglophilia survived the rebuff he received as a young man when his admiration for William Pitt the Elder had led him to knock on the door of Pitt's house in London, by then the home of the Royal Institute of International Affairs. Admitting that he was not a member, he was politely told that in that case, no, he could not come in. A forgiving man, he argued strongly, and successfully, in favour of American help for Britain in its war with Argentina over the Falkland islands in 1982. Britain, in turn, awarded him an honorary knighthood.

His cabinet antagonist in that dispute was Alexander Haig, but Mr Weinberger also squabbled with Reagan's second, less excitable, secretary of state, George Shultz. Though Mr Shultz and Mr Weinberger had worked together for Bechtel, a huge engineering and construction company sometimes considered California's answer to Halliburton, the two bickered constantly in Washington. Paradoxically, the ultra-cautious Mr Weinberger may be seen as the forerunner of Colin Powell, George Bush's first and oft-overwhelmed secretary of state, whereas Mr Shultz had more in common with Mr Rumsfeld, at least as far as the use of force was concerned.

History may judge that Mr Weinberger's role in fortifying America's arsenal, and thus hastening the collapse of the Soviet Union, outweighed everything else that happened on his watch, but even that—because it contributed to a huge budget deficit—was controversial at the time. Worse was to come, though, so much worse indeed that Mr Weinberger's case may be said to support the dictum that all political careers end in failure. That ending came with the Iran-contra affair, the secret deal whereby Reagan agreed to sell arms to Iran in the hope of securing the release of some American hostages, and to use the proceeds of the weapon sales to aid the contras, anti-communist rebels trying to overthrow the government in Nicaragua.

Mr Weinberger had reluctantly agreed to the arms sale, though pointing out its illegality, but claimed he knew nothing of the contra business. He was, nonetheless, indicted by a special prosecutor on charges of perjury and obstruction of justice. In 1987, a year after the scandal had broken, he resigned, but was spared the ignominy of even a trial, let alone a conviction, when George Bush senior gave him a presidential pardon shortly before leaving office.

In his latter years, Mr Weinberger became publisher of *Forbes* magazine, thus returning to an activity he had first indulged in at Harvard, when he wrote for the university newspaper, the *Crimson*. He had been a columnist for several Californian papers in the 1950s and always said, with great charm, that he had also been an occasional correspondent for *The Economist*. Embarrassingly, this was a claim that our records could not corroborate.

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Overview

Mar 30th 2006
From The Economist print edition

European businessmen are facing the world with unusual swagger. German **business confidence** hit a 15-year high in March, by the Ifo Institute's measure, defying analysts who thought that spirits had peaked. Even German retailers are cheering up: last November pessimistic retailers outnumbered optimists by almost 27 percentage points; now their numbers are almost equal. In Italy the ISAE index, based on a survey of about 4,000 firms, reached its highest level for five years. Meanwhile INSEE's measure of French business confidence ebbed only slightly in March from its strong reading in February.

These numbers will embolden interest-rate hawks at the European Central Bank. It released figures showing that the **money supply**, broadly defined, increased by 8% in the year to February, up from 7.6% in the year to January. This is far above the growth rate of 4.5% that the bank believes is consistent with price stability over the long run. Loans to the private sector are also accelerating, up by 10.3% in the year to February.

In Ben Bernanke's first meeting as chairman, the **Federal Reserve's** rate-setting committee raised its key interest rate by a quarter-point to 4.75%, its 15th hike in a row. The Fed reiterated its warning that “some further policy firming may be needed”, prompting investors to sell bonds. The yield on ten-year Treasuries rose above 4.8% during trading.

The Federal Reserve believes growth in the first quarter has “rebounded strongly” from its weakness at the end of last year. The economy's future prospects will depend in large part on the **housing market** and its impact on the consumer. Sales of newly built homes fell dramatically in February, dropping by 10.5% to a seasonally adjusted annual rate of 1.08m. But sales of existing homes rebounded in February, according to the National Association of Realtors, following five months of decline. Sales may have benefited from unusually mild weather the month before. Even so, they remain a little below the pace set in February 2005.

None of this seems to ruffle the American consumer, however. The Conference Board's March index of **consumer confidence**, based on a survey of 5,000 households, jumped to its highest level in almost four years.

Britons borrowed another £8.1 billion ($14.1 billion) against their homes in February, taking their outstanding mortgage debt to £981.8 billion.

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Output, demand and jobs

Mar 30th 2006
From The Economist print edition

% change on year ago

	GDP latest		GDP qtr*	The Economist poll GDP forecasts 2006	2007	Industrial production latest		Retail sales (volume) latest		Unemployment % rate latest		year ago
Australia	+ 2.7	Q4	+ 1.9	+ 3.1	+ 3.3	+ 1.3	Q3	+ 1.9	Q4	5.2	Feb	5.1
Austria	+ 2.1	Q4	+ 2.8	+ 2.1	+ 1.9	+ 7.7	Dec	+ 3.3	Dec	5.0	Feb	5.1
Belgium	+ 1.5	Q4	+ 2.4	+ 2.1	+ 1.9	+ 2.7	Jan	– 2.5	Jan	12.4	Feb†	12.7
Britain	+ 1.8	Q4	+ 2.3	+ 2.1	+ 2.5	– 1.3	Jan	+ 2.1	Feb	5.0	Jan‡	4.7
Canada	+ 2.9	Q4	+ 2.5	+ 3.1	+ 2.8	+ 2.0	Dec	+ 4.9	Dec	6.4	Feb	7.0
Denmark	+ 3.7	Q4	+ 0.3	+ 2.8	+ 2.3	+ 1.1	Jan	+ 4.8	Jan	5.0	Feb	6.0
France	+ 1.2	Q4	+ 0.9	+ 1.9	+ 2.0	+ 0.1	Jan	– 0.3	Jan	9.6	Jan	10.1
Germany	+ 1.0	Q4	nil	+ 1.8	+ 1.2	+ 3.2	Jan	+ 1.7	Jan	11.4	Mar§	12.1
Italy	+ 0.5	Q4	+ 0.1	+ 1.3	+ 1.2	+ 1.0	Jan	+ 1.3	Dec	7.5	Sep	7.9
Japan	+ 4.0	Q4	+ 5.4	+ 2.9	+ 2.4	+ 3.7	Feb	– 0.7	Jan	4.5	Jan	4.5
Netherlands	+ 1.6	Q4	+ 3.2	+ 2.2	+ 1.9	– 0.9	Jan	+ 2.9	Dec	6.1	Feb††	6.5
Spain	+ 3.5	Q4	+ 3.9	+ 3.1	+ 2.7	+ 5.3	Jan	– 0.9	Jan	8.4	Jan	10.1
Sweden	+ 2.9	Q4	+ 2.6	+ 3.3	+ 2.8	+ 5.9	Jan	+ 7.7	Feb	5.6	Feb†	5.7
Switzerland	+ 2.7	Q4	+ 2.1	+ 2.2	+ 1.7	+ 3.9	Q4	+ 3.1	Jan	3.8	Feb†	4.1
United States	+ 3.2	Q4	+ 1.6	+ 3.3	+ 2.8	+ 3.3	Feb	+ 6.1	Jan	4.8	Feb	5.4
Euro area	+ 1.7	Q4	+ 1.2	+ 2.0	+ 1.8	+ 2.5	Jan	+ 0.9	Jan	8.3	Jan	8.8
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 2.9	Q4	+ 3.7	na	na	+ 1.1	Jan	+ 5.8	Jan	8.1	Feb	9.0
Greece	+ 3.7	Q4	na	na	na	+ 1.5	Jan	+ 2.3	Dec	9.7	Q4	10.4
Iceland	+ 3.6	Q4	na	na	na	na		na		1.6	Jan†	3.0
Ireland	+ 4.8	Q3	+ 1.3	na	na	+ 9.9	Jan	+ 9.0	Jan	4.5	Feb	4.3
Luxembourg	+ 3.1	Q1	na	na	na	+ 8.3	Dec	+ 2.6	Jan	4.8	Jan	4.3
New Zealand	+ 1.9	Q4	nil	na	na	– 2.7	Q3	+ 3.0	Q4	3.6	Q4	3.6
Norway	+ 2.5	Q4	+ 1.0	na	na	+ 3.8	nil	+ 2.8	Feb	4.2	Jan**	4.5
Portugal	+ 0.7	Q4	+ 0.4	na	na	+ 2.4	Jan	+ 3.7	Jan	8.0	Q4†	7.1

*% change on previous quarter at an annual rate. †Not seasonally adjusted. ‡Nov-Jan; claimant count rate 2.9% in Feb. §EU harmonised rate 9.1% in Jan. ††Dec-Feb. **Nov-Jan.

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Prices and wages

Mar 30th 2006
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% change on year ago

	Consumer prices			The Economist poll consumer prices forecast		Producer prices			Wages/earnings		
	latest		year ago	2006	2007	latest		year ago	latest		year ago
Australia	+ 2.8	Q4	+ 2.6	+ 2.9	+ 2.7	+ 4.8	Q4	+ 8.2	+ 5.3	Q4	+ 2.9
Austria	+ 1.2	Feb	+ 3.2	+ 2.0	+ 1.8	+ 1.8	Feb	+ 4.6	+ 2.7	Feb	+ 2.1
Belgium	+ 2.4	Feb	+ 2.6	+ 2.2	+ 1.9	+ 3.7	Feb	+ 4.3	+ 2.3	Oct	+ 2.4
Britain	+ 2.0	Feb*	+ 1.6	+ 1.9	+ 1.9	+ 2.9	Feb	+ 2.7	+ 3.5	Jan†	+ 4.2
Canada	+ 2.2	Feb	+ 2.1	+ 2.1	+ 2.2	+ 2.2	Jan	+ 3.7	+ 0.6	Jan	+ 2.0
Denmark	+ 2.1	Feb	+ 1.3	+ 1.9	+ 1.9	+ 4.3	Feb	+ 3.5	+ 2.9	Q4	+ 2.9
France	+ 1.9	Feb	+ 1.6	+ 1.7	+ 1.6	+ 3.5	Feb	+ 3.1	+ 3.3	Q4	+ 3.0
Germany	+ 1.9	Mar	+ 1.8	+ 1.6	+ 2.3	+ 2.9	Feb	+ 3.8	+ 1.1	Jan	+ 1.1
Italy	+ 2.1	Feb	+ 1.9	+ 2.1	+ 1.9	+ 4.9	Feb	+ 4.7	+ 2.3	Dec	+ 3.3
Japan	+ 0.5	Jan	– 0.1	+ 0.3	+ 0.6	+ 2.9	Feb	+ 1.3	– 0.2	Jan	nil
Netherlands	+ 1.1	Feb	+ 1.6	+ 1.5	+ 1.5	+ 6.3	Jan	+ 4.7	+ 1.6	Feb	+ 0.6
Spain	+ 4.0	Feb	+ 3.3	+ 3.3	+ 2.8	+ 6.3	Feb	+ 4.9	+ 2.5	Q4	+ 2.7
Sweden	+ 0.6	Feb	+ 0.7	+ 1.4	+ 1.9	+ 4.9	Feb	+ 2.8	+ 3.4	Dec	+ 2.0
Switzerland	+ 1.4	Feb	+ 1.4	+ 1.1	+ 1.2	+ 1.5	Feb	+ 1.7	+ 0.9	2004	+ 1.4
United States	+ 3.6	Feb	+ 3.0	+ 2.9	+ 2.3	+ 3.7	Feb	+ 4.5	+ 3.5	Feb	+ 2.6
Euro area	+ 2.3	Feb	+ 2.1	+ 2.1	+ 2.1	+ 5.3	Jan	+ 3.9	+ 2.4	Q4	+ 2.4
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 0.9	Feb	+ 0.2	na	na	+ 5.3	Feb	+ 2.2	+ 3.5	Q4	+ 4.3
Greece	+ 3.2	Feb	+ 3.1	na	na	+ 8.9	Feb	+ 4.1	na		na
Iceland	+ 4.5	Mar	+ 4.7	na	na	+ 4.2	Mar	+ 7.0	+ 8.6	Feb	+ 6.7
Ireland	+ 3.3	Feb	+ 2.2	na	na	+ 3.3	Feb	– 0.4	+ 3.5	Q3	+ 4.7
Luxembourg	+ 3.0	Feb	+ 2.2	na	na	+ 3.3	Jan	+19.3	– 0.1	Dec	+ 0.8
New Zealand	+ 3.2	Q4	+ 2.7	na	na	+ 6.5	Q4	+ 3.4	+ 3.1	Q4	+ 2.5
Norway	+ 2.6	Feb	+ 1.0	na	na	+21.0	Feb	+14.4	+ 3.1	Q4	+ 3.9
Portugal	+ 2.8	Feb	+ 2.2	na	na	+ 5.9	Feb	+ 4.0	+ 0.2	Jan	– 1.5

*RPI inflation rate 2.4% in Feb. †Nov-Jan.

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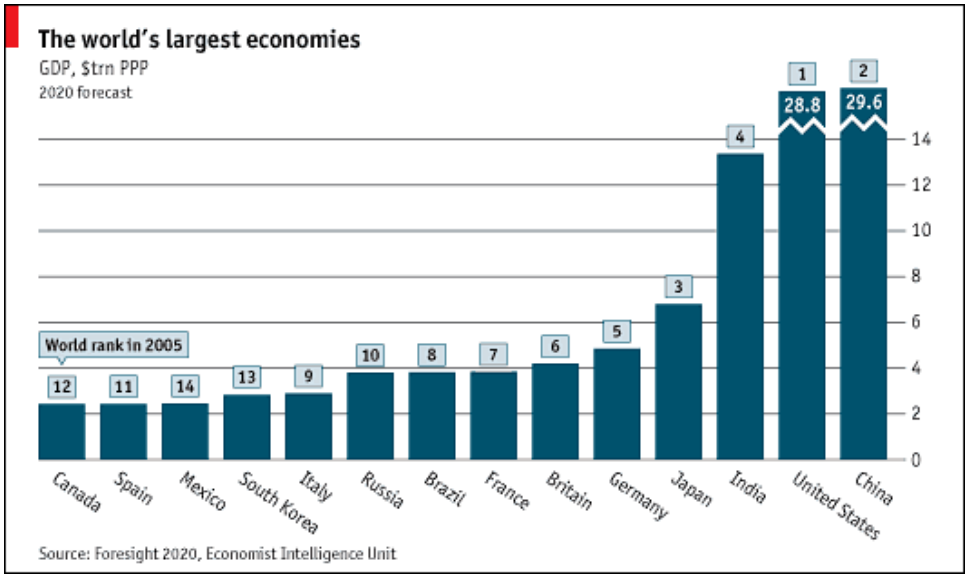
The world's largest economies

Mar 30th 2006
From The Economist print edition



By 2020, China will narrowly outstrip the United States in GDP, according to the Economist Intelligence Unit, a sister organisation of *The Economist*. The forecast uses purchasing-power parities (PPP), which strip out price differences between countries, rather than market exchange-rates to convert national GDPs into a common currency.

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Money and interest rates

Mar 30th 2006
From The Economist print edition

	Money supply* % change on year ago			Interest rates % p.a. (Mar 29th 2006) 3-mth money market		2-year gov't bonds	10-year gov't bonds		corporate bonds
	narrow	broad		latest	year ago		latest	year ago	
Australia	+ 6.4	+ 8.1	Jan	5.61	5.91	5.25	5.38	5.71	6.11
Britain	+ 6.2	+12.2	Feb	4.58	4.95	4.45	4.36	4.72	5.12
Canada	+10.0	+ 6.4	Feb	3.79	2.56	4.00	4.25	4.47	5.32
Denmark	+29.2	+24.0	Jan	2.80	2.20	3.32	3.78	3.73	5.19
Japan	+ 5.5	+ 1.7	Feb	0.04	0.02	0.65	1.79	1.34	1.78
Sweden	+ 1.7	+10.1	Jan	1.99	1.97	2.88	3.60	3.74	3.54
Switzerland	+ 1.4	+ 3.8	Feb	1.25	0.77	1.78	2.47	2.24	2.45
United States	+ 0.4	+ 8.0	Feb	4.77	2.90	4.81	4.80	4.55	5.72
Euro area†	+ 9.9	+ 8.0	Feb	2.80	2.15	3.27	3.71	3.64	4.28

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. † Germany for bonds. Benchmarks: US 30-year 4.84%, Japan No. 277 1.78%. Central bank rates: US fed funds 4.75%, ECB refinancing 2.50%, BOJ overnight call 0%, BOE repo 4.5%. Sources: Bank of Canada, Commerzbank, Danske Bank, Global Insight, JPMorgan Chase, Stockholmsbörsen, UBS, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

Mar 30th 2006
From The Economist print edition

2000=100

	Mar 21st	Mar 28th*	% change on one month	% change on one year
Dollar index				
All items	155.6	155.1	– 0.0	+14.3
Food	133.5	130.8	– 4.8	+ 1.4
Industrials				
All	184.2	186.5	+ 4.8	+29.3
Nfa†	146.6	147.7	– 1.5	+11.2
Metals	204.7	207.7	+ 7.4	+38.0
Sterling index				
All items	135.0	134.4	+ 0.1	+22.5
Euro index				
All items	119.0	118.7	– 1.4	+22.2
Yen index				
All items	169.0	168.1	+ 0.8	+24.3
Gold				
$ per oz	549.85	567.75	+ 1.4	+33.1
West Texas Intermediate				
$ per barrel	60.20	66.01	+ 7.1	+21.8

*Provisional. †Non-food agriculturals.

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Stockmarkets

Mar 30th 2006
From The Economist print edition

Market indices

	Mar 29th	2006 high	2006 low	% change on one week	% change on record high	% change on Dec 30th 2005 in local currency	% change on Dec 30th 2005 in $ terms
Australia (All Ordinaries)	5,049.4	5,049.4	4,708.8	+ 1.5	nil	+ 7.2	+ 2.9
Austria (ATX)	4,053.1	4,158.6	3,682.4	- 0.6	- 2.5	+10.5	+12.4
Belgium (Bel 20)	3,913.8	3,978.0	3,573.9	- 1.6	- 1.6	+10.3	+12.1
Britain (FTSE 100)	5,959.2	6,036.3	5,618.8	- 0.8	-14.0	+ 6.1	+ 7.1
Canada (Toronto Composite)	12,190.6	12,190.6	11,272.3	+ 1.8	nil	+ 8.1	+ 7.6
Denmark (OMXCB)	388.2	395.5	362.0	- 1.3	- 1.8	+ 5.5	+ 7.3
France (SBF 250)	3,656.9	3,679.2	3,327.6	- 0.1	-16.7	+10.8	+12.7
(CAC 40)	5,180.3	5,218.7	4,748.3	- 0.3	-25.2	+ 9.9	+11.7
Germany (DAX)*	5,914.8	5,973.1	5,334.3	- 0.3	-26.7	+ 9.4	+11.2
Italy (S&P/MIB)	37,700.0	38,602.0	35,652.0	- 2.1	-24.8	+ 5.6	+ 7.4
Japan (Nikkei 225)	16,938.4	16,938.4	15,341.2	+ 2.7	-56.5	+ 5.1	+ 5.0
(Topix)	1,711.5	1,713.5	1,572.1	+ 1.5	-40.7	+ 3.7	+ 3.7
Netherlands (AEX)	469.0	472.1	431.5	nil	-33.2	+ 7.4	+ 9.2
Spain (Madrid SE)	1,282.8	1,294.9	1,156.8	- 0.8	- 0.9	+10.9	+12.8
Sweden (Affarsvarlden Gen)	327.9	328.2	287.3	+ 1.2	-18.1	+11.8	+13.2
Switzerland (Swiss Market)	7,983.4	8,064.0	7,583.9	- 1.0	- 5.1	+ 5.3	+ 5.8
United States (DJIA)	11,215.7	11,317.4	10,667.4	- 0.9	- 4.3	+ 4.6	+ 4.6
(S&P 500)	1,302.9	1,307.3	1,248.3	- 0.2	-14.7	+ 4.4	+ 4.4
(NASDAQ Comp)	2,337.8	2,337.8	2,205.3	+ 1.5	-53.7	+ 6.0	+ 6.0
Europe (FTSEurofirst 300)†	1,367.5	1,383.2	1,277.1	- 0.7	-19.8	+ 7.2	+ 9.0
Euro area (FTSE Euro 100)†	1,177.7	1,190.6	1,078.9	- 0.9	-24.0	+ 8.1	+10.0
World (MSCI)‡	1,332.3	1,340.1	1,259.1	- 0.4	- 8.0	+ 5.9	+ 5.9
World bond market (Citigroup)††	615.6	638.9	613.5	- 1.1	- 3.7	- 0.8	- 0.8

*Total return index. †In euro terms. ‡Morgan Stanley Capital International Index includes individual markets listed above plus eight others, in $ terms. ††Citigroup World Government Bond Index, total return, in $ terms.

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Trade, exchange rates and budgets

Mar 30th 2006
From The Economist print edition

	Trade balance*, $bn latest 12 months		Current-account balance $bn latest 12 mths		The Economist poll % of GDP, forecast 2006	2007	Exchange rate trade-weighted† 2000=100 Mar 29th	year ago	Currency units per $ Mar 29th	year ago	per £	per euro	per ¥100	Budget balance % of GDP 2005‡
Australia	− 14.2	Jan	− 42.1	Q4	− 5.4	− 4.0	113.0	115.8	1.42	1.29	2.46	1.70	1.20	+ 1.0
Austria	− 1.9	Dec	+ 0.5	Dec	+ 0.2	+ 0.2	104.9§	105.9	0.83	0.77	1.45	–	0.71	− 2.0
Belgium	+ 12.9	Jan	+ 8.2	Sep	+ 2.2	+ 2.3	106.6§	107.9	0.83	0.77	1.45	–	0.71	nil
Britain	−119.3	Jan	− 57.4	Q4	− 2.3	− 2.3	97.3	100.4	0.58	0.53	–	0.69	0.49	− 3.1
Canada	+ 57.8	Jan	+ 25.2	Q4	+ 2.0	+ 1.4	123.9	117.7	1.17	1.22	2.04	1.41	0.99	+ 1.3
Denmark	+ 9.4	Jan	+ 7.4	Jan	+ 2.9	+ 2.7	106.2	106.5	6.22	5.75	10.8	7.46	5.26	+ 2.8
France	− 29.2	Jan	− 39.7	Jan	− 1.3	− 1.1	107.3§	108.8	0.83	0.77	1.45	–	0.71	− 3.2
Germany	+197.8	Jan	+111.0	Jan	+ 3.9	+ 3.9	108.7§	110.4	0.83	0.77	1.45	–	0.71	− 3.9
Italy	− 14.6	Jan	− 26.5	Jan	− 1.5	− 1.4	106.9§	108.3	0.83	0.77	1.45	–	0.71	− 4.3
Japan	+ 89.0	Jan	+162.7	Jan	+ 3.7	+ 3.5	81.7	86.8	118	107	205	142	–	− 6.5
Netherlands	+ 39.0	Jan	+ 39.8	Q4	+ 5.2	+ 5.1	107.4§	108.7	0.83	0.77	1.45	–	0.71	− 1.6
Spain	− 97.6	Jan	− 85.5	Dec	− 6.9	− 7.0	105.2§	106.1	0.83	0.77	1.45	–	0.71	+ 0.3
Sweden	+ 19.2	Feb	+ 21.8	Q4	+ 6.7	+ 6.3	95.3	99.5	7.86	7.04	13.6	9.43	6.65	+ 1.2
Switzerland	+ 7.0	Feb	+ 49.3	Q3	+13.1	+12.4	105.2	107.6	1.31	1.20	2.27	1.57	1.11	− 1.6
United States	−792.6	Jan	−804.9	Q4	− 6.8	− 6.8	87.3	82.7	–	–	1.73	1.20	0.85	− 3.7
Euro area	+ 18.1	Jan	− 40.3	Jan	− 0.1	nil	116.9	118.5	0.83	0.77	1.45	–	0.71	− 2.9
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*													
Finland	+ 10.4	Jan	+ 5.3	Jan	na	na	108.1§	109.4	0.83	0.77	1.45	–	0.71	+ 2.1
Greece	− 34.2	Dec	− 18.1	Jan	na	na	103.6§	105.1	0.83	0.77	1.45	–	0.71	− 4.5
Iceland	− 1.6	Jan	− 2.6	Q4	na	na	106.8**	95.0	71.7	61.1	124	86.0	60.7	+ 2.0
Ireland	+ 39.6	Jan	− 3.7	Q3	na	na	112.1§	114.7	0.83	0.77	1.45	–	0.71	− 0.9
Luxembourg	− 4.8	Dec	+ 3.5	Q3	na	na	106.6§	107.9	0.83	0.77	1.45	–	0.71	− 2.3
New Zealand	− 5.0	Feb	− 9.6	Q4	na	na	122.6	135.0	1.66	1.41	2.87	1.99	1.40	+ 5.3
Norway	+ 50.6	Feb	+ 49.5	Q4	na	na	110.0	107.2	6.64	6.31	11.5	7.97	5.62	+ 15.3
Portugal	− 23.0	Dec	− 16.6	Jan	na	na	104.6**	104.3	0.83	0.77	1.45	–	0.71	− 6.0

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, January average. ‡OECD estimate.
**IMF, November average.

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Coffee

Mar 30th 2006
From The Economist print edition

Coffee prices are at their highest since mid 1998. In 2005-06 production fell below demand for the second season in a row. Coffee stocks in Brazil are half what they were a year ago. But Brazil's output is set to rise sharply in 2006-07.

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Overview

Mar 30th 2006
From The Economist print edition

Saudi Arabia's stockmarket rebounded by 8.8% during the week. But share prices are still 17% below their peak in February.

South Korea's current-account surplus narrowed to $11.1 billion in the year to February, less than half its level of a year earlier. **Mexico's** trade deficit fell to $4.9 billion in the same period, its smallest since 2001.

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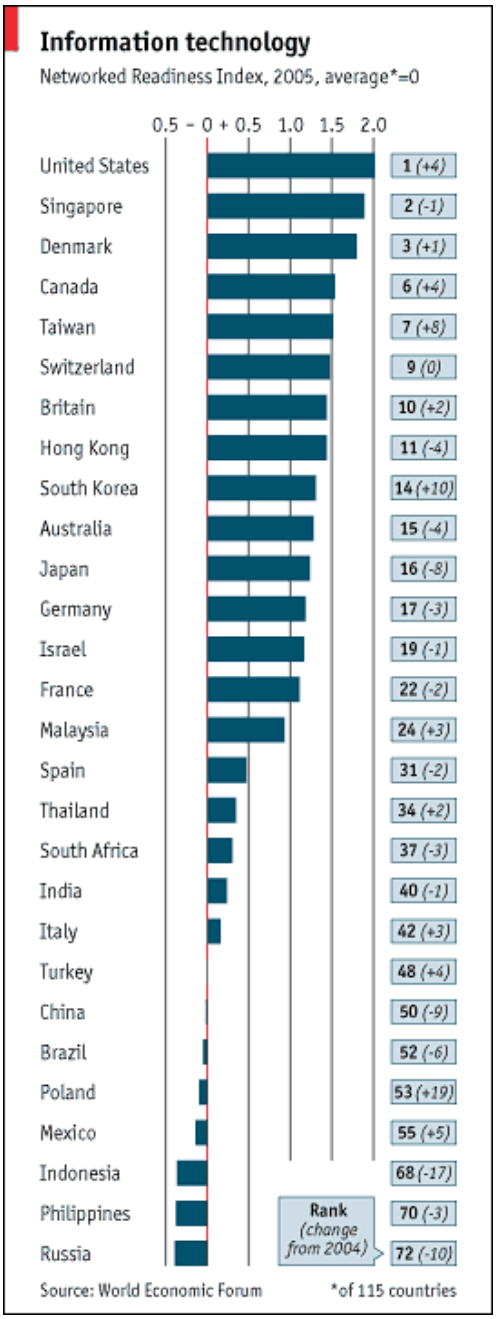
Information technology

Mar 30th 2006
From The Economist print edition

America has returned to the top of the World Economic Forum's fifth annual "networked readiness index", which measures countries' ability to benefit from computing and communications. The rankings assess a country's economy, regulatory conditions and infrastructure, as well as its adoption and usage of technology. Japan, India and China all slipped down the table.



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Economy

Mar 30th 2006
From The Economist print edition

	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 9.9	Q4	+16.2	Feb	+ 0.9	Feb	+102.6	Feb	+128.5	H1	853.7	Feb
Hong Kong	+ 7.6	Q4	+ 5.9	Q4	+ 1.6	Feb	−11.3	Feb	+19.7	Q4	125.7	Feb
India	+ 7.6	Q4	+ 8.3	Jan	+ 4.4	Jan	−38.0	Feb	−18.3	Q3	136.6	Feb
Indonesia	+ 4.9	Q4	−15.4	Jan	+17.9	Feb	+29.1	Jan	+ 0.7	Q3	33.3	Jan
Malaysia	+ 5.2	Q4	+ 2.6	Jan	+ 3.2	Feb	+26.8	Jan	+18.7	Q3	70.7	Jan
Pakistan	+ 8.4	2005†	+19.3	Sep	+ 8.0	Feb	−10.1	Feb	− 3.7	Q4	9.8	Jan
Philippines	+ 6.1	Q4	− 2.8	Jan	+ 7.6	Feb	− 3.8	Jan	+ 2.4	Dec	18.0	Feb
Singapore	+ 8.7	Q4	+37.2	Feb	+ 1.2	Feb	+30.6	Feb	+33.2	Q4	120.2	Feb
South Korea	+ 5.3	Q4	+20.0	Feb	+ 2.3	Feb	+19.3	Feb	+11.1	Feb	215.9	Feb
Taiwan	+ 6.4	Q4	+14.1	Feb	+ 1.0	Feb	+ 7.6	Feb	+16.4	Q4	257.0	Feb
Thailand	+ 4.7	Q4	+ 5.8	Jan	+ 5.6	Feb	− 7.5	Jan	− 2.3	Jan	51.7	Jan
Argentina	+ 9.1	Q4	+ 8.6	Feb	+11.5	Feb	+11.3	Jan	+ 5.4	Q4	18.7	Jan
Brazil	+ 1.4	Q4	+ 3.2	Jan	+ 5.5	Feb	+45.5	Feb	+13.5	Feb	56.3	Jan
Chile	+ 5.8	Q4	+ 5.0	Feb	+ 4.1	Feb	+ 9.7	Feb	+ 0.7	Q4	16.1	Feb
Colombia	+ 5.8	Q3	+ 0.9	Dec	+ 4.2	Feb	+ 1.4	Jan	− 1.7	Q3	14.9	Feb
Mexico	+ 2.7	Q4	+ 6.0	Jan	+ 3.7	Feb	− 4.9	Feb	− 5.7	Q4	76.7	Jan
Peru	+ 4.4	Jan	+ 4.1	Jan	+ 2.7	Feb	+ 5.2	Jan	+ 1.0	Q4	13.0	Feb
Venezuela	+10.2	Q4	+13.5	Dec	+12.5	Feb	+31.5	Q4	+25.4	Q4	23.9	Dec
Egypt	+ 5.2	Q1	+ 4.0	2005†	+ 3.4	Jan	−11.1	Q4	+ 1.8	Q3	21.3	Feb
Israel	+ 4.8	Q4	+ 8.4	Jan	+ 3.1	Feb	− 8.7	Feb	+ 2.4	Q4	28.0	Feb
Saudi Arabia	+ 6.5	2005‡	na		+ 1.2	Dec	+84.6	2004	+51.9	2004	26.0	Jan
South Africa	+ 4.5	Q4	+ 5.6	Jan	+ 3.9	Feb	− 4.1	Jan	−10.1	Q4	20.2	Feb
Czech Republic	+ 6.9	Q4	+15.1	Jan	+ 2.8	Feb	+ 1.7	Jan	− 2.6	Q4	29.4	Feb
Hungary	+ 4.3	Q4	+11.0	Jan	+ 2.5	Feb	− 3.4	Jan	− 8.7	Q3	19.8	Feb
Poland	+ 4.2	Q4	+10.1	Feb	+ 0.7	Feb	− 2.9	Jan	− 4.5	Jan	43.7	Feb
Russia	+ 7.0	Q4	+ 1.0	Feb	+11.1	Feb	+124.3	Jan	+86.6	Q4	197.9	Feb
Turkey	+ 7.0	Q3	− 4.5	Jan	+ 8.2	Feb	−43.9	Jan	−23.4	Jan	52.9	Jan
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Estonia	+10.5	Q4	+12.1	Jan	+ 4.6	Feb	− 2.4	Dec	− 1.3	Jan	1.9	Jan
Latvia	+10.5	Q4	+11.2	Jan	+ 6.1	Feb	− 3.0	Jan	− 2.0	Jan	2.3	Jan
Lithuania	+ 8.2	Q4	na		+ 3.4	Feb	− 3.8	Jan	− 1.9	Jan	4.0	Jan
Slovakia	+ 7.5	Q4	+ 7.7	Jan	+ 4.4	Feb	− 2.7	Jan	− 3.0	Nov	15.1	Jan
Slovenia	+ 5.1	Q4	+ 6.6	Jan	+ 2.2	Feb	− 1.7	Jan	− 0.2	Jan	8.1	Dec

*Excluding gold, except Singapore and China; IMF definition. †Year ending June. ‡Economist Intelligence Unit estimate.

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Financial markets

Mar 30th 2006
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Mar 29th		Dec 30th 2005	
	Mar 29th	year ago	Mar 29th	% a year		one week	in local currency	in $ terms
China	8.03	8.28	13.9	2.40	1,369.0	+0.7	+ 12.1	+ 12.7
Hong Kong	7.76	7.80	13.5	4.47	15,745.1	+0.7	+ 5.8	+ 5.7
India	44.7	43.7	77.4	6.50	11,183.5	+3.2	+ 19.0	+ 19.9
Indonesia	9,150	9,505	15,863	13.65	1,323.0	+1.6	+ 13.8	+ 22.4
Malaysia	3.70	3.80	6.41	3.51	933.0	+1.2	+ 3.7	+ 6.0
Pakistan	60.0	59.4	104	9.03	11,414.3	+1.2	+ 19.4	+ 19.1
Philippines	51.3	54.8	88.9	7.38	2,181.6	-0.1	+ 4.1	+ 7.6
Singapore	1.62	1.65	2.81	3.44	2,520.8	+1.3	+ 7.4	+ 10.1
South Korea	975	1,024	1,691	4.26	1,332.7	+1.7	- 3.4	+ 0.2
Taiwan	32.6	31.8	56.5	1.68	6,498.0	+1.7	- 0.8	nil
Thailand	39.0	39.3	67.5	5.10	724.9	+0.1	+ 1.6	+ 6.9
Argentina	3.08	2.92	5.34	9.63	1,803.9	+0.6	+ 16.9	+ 14.9
Brazil	2.23	2.68	3.87	16.54	37,491.0	-0.9	+ 12.1	+ 17.3
Chile	536	586	930	4.68	9,930.9	+0.7	+ 7.9	+ 3.0
Colombia	2,287	2,374	3,964	5.92	11,149.6	+3.0	+ 17.2	+ 17.2
Mexico	11.0	11.2	19.0	7.27	19,132.3	-2.4	+ 7.5	+ 4.2
Peru	3.32	3.26	5.76	4.06	5,943.8	+1.3	+ 23.8	+ 27.9
Venezuela	2,557§	2,927§	4,433	10.19	29,692.0	+1.5	+ 45.6	+ 47.2
Egypt	5.75	5.80	9.96	8.61	58,345.7	+1.7	+ 5.4	+ 5.3
Israel	4.70	4.37	8.15	5.28	844.9	-2.2	+ 2.0	- 0.1
Saudi Arabia	3.75	3.75	6.50	5.11	17,060.3	+8.8	+ 2.1	+ 2.1
South Africa	6.34	6.28	11.0	7.20	20,327.6	+1.7	+ 12.3	+ 12.4
Czech Republic	23.9	23.1	41.5	2.09	1,516.4	-1.5	+ 2.9	+ 6.0
Hungary	223	191	386	6.43	22,829.1	+1.4	+ 9.8	+ 5.6
Poland	3.29	3.17	5.71	4.16	39,621.1	+1.9	+ 11.3	+ 10.0
Russia	27.8	27.9	48.2	12.00	1,391.3‡	-1.2	+ 19.6	+ 23.6
Turkey	1.36	1.36	2.36	14.25	42,507.0	-4.1	+ 6.9	+ 6.1
EM (MSCI)*	1.00	1.00	1.73	na	772.3	+0.2	+ 9.3	+ 9.3
EMBI+†	1.00	1.00	1.73	na	375.0	-0.7	+ 1.7	+ 1.7

*Emerging Mkts. †JPMorgan Chase's Emerging Mkts Bond Index Plus. ‡In $ terms. §Floating exchange rate.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; Bank Leumi le-Israel; Standard Bank Group

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